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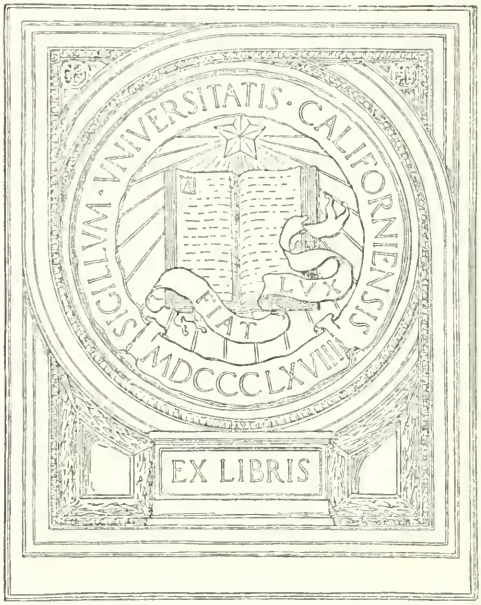

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WAR-TIME FINANCIAL PROBLEMS

WORKS BY HARTLEY WITHERS

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WAR-TIME FINANCIAL PROBLEMS

BY

HARTLEY WITHERS

"Blest paper credit! last and best supply!
That lends Corruption lighter wings to fly!
Gold imp'd by thee, can compass hardest things,
Can pocket States, can fetch or carry Kings;
A single leaf shall waft an Army o'er,
Or ship off Senates to a distant Shore;
A leaf, like Sibyl's, scatter to and fro
Our fates and fortunes, as the winds shall blow;
Pregnant with thousands flits the Scrap unseen,
And silent sells a King, or buys a Queen."

POPE, *Moral Essays.*

LONDON
JOHN MURRAY, ALBEMARLE STREET, W.
1920

PREFACE

At a time when Finance is of greater importance than ever before, it is hoped that this small volume may be of interest and value to the public, and help the application of war's lessons to the problems that face us in peace.

The contents, with the exception of the last article on "Money or Goods?" (which appeared in the Trade Supplement of the *Times* for December, 1918), have already been published in *Sperling's Journal*, from September, 1917, to March, 1919; they have been left as they were written, except for a few verbal corrections.

I desire to express my thanks to the Editors of *Sperling's Journal* and of the *Times* for their kind permission to reprint the articles.

H. WITHERS.

June, 1919.

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WAR-TIME FINANCIAL PROBLEMS

I

THE OUTLOOK FOR CAPITAL

September, 1917

The Creation of Capital—The Inducement—War and Capital.

ONE of the questions that are now most keenly agitating the minds of the investing public and of financiers who cater for its wants, and also of employers and organisers of industry who are trying to see their way into after-the-war conditions, is that of the supply of capital. On this subject there are two contradictory theories: one considers that owing to the destruction of capital during the war, capital will be for many years at a famine price; the other, that owing to the exhaustion of all the warring powers, that is, of the greater part of the civilised world, the spirit of enterprise will be almost dead, the demand for capital will be extremely limited, and consequently the supply of it on offer will go begging to find a user. It seems likely that, as usual, the truth lies somewhere between these two extreme views; but we shall best answer the question

if we first get a clear idea of what we mean by capital.

On the subject of the definition of capital, economists differ with all the consistency that they only show in differing. One of the earliest descriptions of capital was given by Turgot, who thought that capital meant " valeurs accumulées." In this wide sense the word covers all goods which have value, that is, can be exchanged into other goods. From this point of view, the schoolboy who invests sixpence in marbles is a capitalist, because he has bought an asset which is not immediately consumed, but can, later on, if his fancy urges him, be exchanged into white mice or any other object of his desire. On the other hand, the schoolfellow who at the same time spends sixpence on cherries and eats them has put his money into immediate consumption, his asset is digested, and he has no capital in any sense of the word.

Later, the definition was narrowed by John Stuart Mill, for instance, into the sense of wealth set aside to increase production. From this point of view capital practically means the equipment and tools of industry in the widest sense of the word, including agriculture and transport. Lately economists have shown a tendency to go back to the wider application of the word, and an American economist, Dr Anderson, who has just published a book on the Value of Money, goes so far therein as to state that a " dollar is capital." The language of the City generally uses the word in the narrow sense adopted by Mill, and there is very much to be said for this view of the

real meaning of capital. Marbles to play with, houses to live in, motor-cars to go joy-riding in—all these are assets which can be disposed of, and so, in a sense, may be called capital. But the business-like meaning of the word is the tools and equipment of industry, because it is only by their possession that the wealth of mankind not only increases man's present enjoyment, but enhances his future output of the goods necessary for his existence.

If we take the word in this sense it becomes at once apparent that the theory is exaggerated which maintains that war is destroying capital, so that capital will long be at a famine price. The extent to which war is actually destroying the tools and equipment of industry is quite limited. On the actual battlefield that sort of destruction proceeds apace when factories are shelled into shapeless lumps of bricks, and when the surface of the earth, that man's skill had developed into great productive fertility, is torn into craters and covered with rubbish. There is also rapid destruction of a very important part of the equipment of industry owing to the submarine campaign, which is sinking so many fine ships that were meant to carry goods from one country to another. But, apart from this actual destruction on the battlefield and on the sea, the tools and equipment of industry over the greater part of the earth remain untouched. It is true that, owing to the preoccupations of the war, not so much work as usual is being put into the upkeep and repair of our railways, factories and other industrial tools. But at the same time an enormous amount of new

machinery is being created for the manufacture of munitions and other stuff needed for the war, and a large part of this new machinery ought to be available as industrial capital when the war is over. Those people who talk so glibly of the enormous destruction of capital by the war are surely making a mistake common to minds which look at economic questions through a financial telescope, mistaking money for capital. They see that an enormous amount of money is being spent on the war, and they jump to the conclusion that this money, if not spent upon the war, would have been put into capital investments and so have increased the tools and equipment of industry. In fact, a great deal of the money now spent upon the war would have been spent, if there had been no war, not upon increasing the equipment of production, but upon purely frivolous and extravagant consumption. There is no need to dwell on the effect of war in reducing many kinds of expenditure on which hundreds of millions must have gone in peace time, and this restriction of extravagant consumption has to be deducted before we even admit, not that all money spent upon the war is destroyed capital, but even that all the money spent upon the war is destroying what might otherwise have become capital.

If, then, it is true that the war is not making a very terribly substantial inroad upon the mass of existing capital, how is it going to affect the supply of capital in the future? To answer this question we have to see how capital is created. The answer to this question is very simple, very obvious,

and very dull. Capital can only be created by saving.

Saving is such an entirely unpopular virtue that it seems at first sight a disastrous conclusion to arrive at, that if we want to increase the supply of capital it can only be done by stimulating this unattractive habit ; and there is a further question to be asked—whether it will be necessary or desirable to have a great increase in the supply of capital. As was pointed out above, one theory of after-war needs maintains that the world will be so exhausted by this great struggle that it will have no enterprise and no energy left, and that capital will go begging. If this be so, we need not trouble to inquire as to whether the supply of capital can be made plentiful. But I venture to think that this view is very probably wrong, though it is very dangerous to prophesy concerning the purely psychological question of the state of mind in which the citizens of the warring Powers will end the war. It is, however, at least probable that the prices which are then likely to rule will stimulate enterprise all over the world ; that every one will see that there is a great work to be done in getting industry back on to a peace basis, and a great profit to be made by those who do this work most successfully, and that the demand for capital is likely, for some years at least, to clamour for all that can be produced.

To go back, then, to the statement that only by saving can capital be created. The man who saves, instead of spending money on his own enjoyment, hands it over to some company or Government to be

spent on some industrial or national purpose. When it is put into industry it builds a factory or a ship or a railway or a canal, or clears a wilderness for cultivation, or does one of the innumerable other things which are necessary for the production and transport of the goods which mankind enjoys. And it is only by this process of handing over buying power, instead of using it for our own amusement and enjoyment, to others who will use it for furthering production that the tools and equipment of industry can be multiplied.

Something can be done by banks and financiers in supplying credit in the form of advances and acceptances ; but this method is only like oiling the wheel of industry, the real driving power of which has to be saved capital. Creating credits simply means that a certain amount of buying power is manufactured and handed over to those to whom the credit is given. It does not set free any labour or goods to be put into industry. That is only done by the man who abstains from consumption and saves money by restraining his desire to spend it on himself, and puts it at the disposal of industry. The man who saves money, who has always hitherto been rather despised by his companions and resented by a certain class of social reformer and many other uneducated people as a capitalist bloodsucker, is thus, in fact, the person who leaves the world richer than he found it, having put his money, the product of his own work, into increasing the world's output, instead of spending it on such forms of enjoyment as heavy lunches and cinema shows.

The man who does this beneficent work, increasing mankind's output of goods, and providing employment as long as the factory or railway that he helps to build is running, is induced to do so, as a rule, by the purely selfish motive of providing for his old age or for those who come after him by earning the rate of interest that is paid to him for his capital. What is this rate of interest going to be, and how much effect does it have upon the creation of capital ?

Some people argue that a low rate of interest makes people save more because it is necessary for them to save more in order to acquire independence. Others maintain that a high rate of interest induces people to save because they can see the direct advantage of doing so. Both these arguments are probably true in some cases. But, as a rule, people who have the instinct of saving will save, within certain limits, whatever the rate of interest may be. When the rate of interest is low they will certainly not reduce their saving because each hundred pounds that they put away brings them in comparatively little, and when the rate of interest is high the attraction of the high rate will also deter them from diminishing the amount that they put aside. Moreover, we have to consider, not only the money payment involved by the rate of interest, but its buying power in goods. In 1896 trustee securities could only be bought to return a yield of $2\frac{1}{2}$ per cent. for the buyer ; now the investor can get $5\frac{1}{4}$ per cent. and more from the British Government. And yet the power that this $5\frac{1}{4}$ gives him over the goods and services that he

wants for his comfort is probably not greater, and very likely rather less, than the power which he got in 1896 from his $2\frac{1}{2}$ per cent. One of the few facts which seem to stand out clearly from a study of the movement of the prices of securities, and consequently of the rate of interest to be derived from them, is that the rate of interest is high when the price of commodities is high, and vice versa. So that the answer to the question: What is the rate of interest likely to be after the war? may be given, in Quaker fashion, by another question: What will happen to the index number of the prices of commodities? It seems fairly probable that both these questions may be answered, very tentatively and diffidently, by the expression of a hope that after a time, when peace conditions have settled down and all the merchant ships of the world have been restored to their peaceful occupations, the general level of the price of commodities will be materially lower than it is now, though probably considerably higher than it was before the war. If this be so, then it is fairly safe to expect that the rate of interest, as expressed in money, will follow the movement of prices of goods. But it must be remembered that by rate of interest I mean the pure rate of interest, that is to say, the rate earned on perpetual fixed-charge securities of the highest class. It may be that, owing to the very large amount of gilt-edged securities created in the course of the war by the various warring Governments, the rate of profit to be earned by the man who takes the risks of industry from dividends on ordinary shares and stocks will

have to be made relatively more attractive than it was before the war.

If, then, capital can only be created by saving, how far will the war have helped towards its more plentiful production ?

Here, again, we are faced with a psychological question which can only be answered by those who are bold enough to forecast the state of mind in which the majority of people will find themselves when the war is over. If there is a great reaction, and everybody's one desire is to throw this nightmare of war off their chests and go back to the times as they were before it happened, then all that the war has taught us about the production of capital will have been wasted. But I rather doubt whether this will be so. Saving merely means the diversion of a certain proportion of the output of industry into the further equipment of industry. The war has taught us lessons which, if we use them aright, will help us to increase enormously the output of industry. So that if these lessons are used aright, and industry does not waste its time in squabbles over the sharing of its product, its output may be so great that a comparatively smaller amount of saving in relation to the total output may produce a larger amount of capital than was made available in days before the war. There is a further point, that the war has taught a great many people who never saved at all to save a good deal. It was estimated before the war that we in this country were saving about four hundred millions a year. This figure was necessarily a guess, and must be taken for what it is worth.

There can be no doubt that the amount of real saving now in progress, voluntary, owing to the patriotic effort of people who think they ought to restrict their own consumption so that the needs of our fighters may be provided, and enforced through the action of the Government in taking taxes and inflating the currency, is very much greater than it was before the war ; probably at least twice as much when all allowance has been made for depreciation of the currency. Some people think that this saving lesson will have been learned, will have become a habit, will continue and will grow. If so, if people save a larger proportion of their income than they did before, and if the total output of goods is increased, as it easily may be, it becomes at once evident that there is a possibility of a freer supply of capital for industry than has ever been seen. But in looking at this hopeful and optimistic picture, we must never forget that it can only be painted by those who are prepared to leave out of the canvas all the danger of industrial strife and dislocation, and all the danger of reaction to the old habits of luxurious spending which are so strong a possibility in the other direction. The war has shown us how we can, if we like, increase production, reduce consumption, and so have a larger margin than ever before to be put into providing capital for industry. Whether we really have learned these lessons and will apply them remains to be seen.

There is also a possibility that some people may recognise that saving money and applying it to the re-equipment of the world for peace industry is a patriotically praiseworthy object not less than saving

in time of war for the equipment of the Army. It may be that the benefit conferred by those who save, in increasing the output of mankind, will be more generally recognised, and that the supply of capital may, when the war is over, be increased on patriotic grounds, or on grounds even wider than mere patriotism—a desire to help a great stride forward in the material welfare of mankind.

Capital is a very tender plant, and it will be very easy, if mistakes are made, to frighten those who see the benefits of accumulation for themselves and others. Labour troubles and industrial unrest are extremely likely to have the effect of destroying capital by preventing it coming into existence. If we remember that capital can only be created by being saved, it becomes evident that if those who save are threatened with too deep an inroad into their reward for so doing, on the part of labour, they will hesitate to save ; and if the action of labour has this effect, labour will be sawing off the bough on which it sits. For it is new capital that sets new industry going, and it is only by a continual supply of new industry that a continual demand for fresh labour can be maintained.

There is also at present much mischievous talk about a great tax on capital for the purpose of redeeming, or hastening the redemption of, war debt. It is clear at once that it is not possible to tax capital if we remember that capital consists of the tools and equipment of industry, or even, in the wider sense of the word, of accumulated assets which have not been consumed. Unless the Government is pre-

pared to take payment in factory chimneys, railway sleepers, houses and fields, or the securities and mortgages that are claims on their product, it is not possible to tax capital. The only thing that the Government can tax is the output, that is to say, the annual income of the people. In other words, a tax on capital is simply a form of income tax assessed, not according to a man's income, but according to the assets of which he is possessed. The effect of such a tax would be that he who has spent everything that he has earned on his own enjoyment would go scot free in the matter of the capital tax, and would be rewarded for his improvidence by being asked to make no sacrifice ; while his thrifty brother who, out of a smaller income, has set aside a certain proportion during the last twenty or thirty years, would have to hand over a portion of his current income assessed upon the value of the assets into which he has put his savings. Incidentally, it may be remarked that it would take years to make this necessary valuation, and that it would probably be done in a very inequitable manner by untrained and incompetent officials. But the important point is this, that if the Government shows a tendency to take the possession of assets as a basis for taxation it will be directly encouraging those who spend their whole income in riotous living and frivolous amusement, and discouraging those who help to increase mankind's output by adding to the capital available.

Finally, it may be added that the shyness of the saver will be greatly diminished if he can feel that there is a trustworthy machinery of company

promotion, so that he can rely on any savings that he puts into industry having at least a fair chance of yielding him a fair reward. This subject is too vast to enter into at present, but it is one to which those who are responsible for the management of our financial affairs cannot give too much attention. Every time the real investor is swindled out of his money there is more than a chance that he will look upon all forms of saving as a folly to be left to the credulous. It is easy to say that it was his own fault, that he ought to have been more careful, or consulted a better broker ; but he will, with equal ease, retort that if honest financiers knew their business better, they would have long ago made things easier for the ignorant investor to know whether he was putting his money into genuine enterprise or throwing it down a sink.

Like all other divagations on the subject of what may happen in the future, this attempt to forecast has necessarily consisted of " dim glimpses into the obvious," as the undergraduate said of Jowett's sermon. All that we can be sure of is this : that if the great opportunities that will lie open to mankind at the end of the war are rightly used, if we use its lessons to increase our production, restrict our frivolous consumption, and put a larger proportion of our larger production into stimulating production still further, there ought to be a great increase in the amount of capital available to supply the great increase which may be expected in the amount of capital demanded. The fact that the chief nations of the world will have enormous debts on which to

pay interest is not one that need necessarily terrify us from this point of view. The arranging and imposition of the taxation necessary for meeting the interest on these debts will involve very serious political and social questions; but the payment of this interest need not necessarily diminish production, and it may probably help in checking consumption. It will not impair the total wealth of the world as a whole; it will merely affect its distribution. And since it will mean that a considerable part of the world's output will, for this reason, be handed over to the holders of the various Government debts, who, *ex hypothesi*, will be people who have saved money in the past, it is at least possible that they may devote a considerable amount of the sum so received to further saving or increasing the supply of capital available.

II

LONDON'S FINANCIAL POSITION

October, 1917

London after the War—A German View—The Rocks Ahead—Our Relative Position secure—Faulty Finance—The Strength we have shown—The Nature and Limits of American Competition—No other likely Rivals.

WILL the prestige of the London money market be maintained when the war is over? This is a question of enormous importance, not only to every one who works in and about the City, but to all who are interested in the maintenance and increase of England's wealth. Like all other questions about what is going to happen some day, the answer to it will depend to a very great extent on what happens between the present moment and the return of peace. To arrive at an answer we have first to consider on what London's financial prestige has been based in the past, and on this subject we are able to cite in evidence the opinion of an enemy. Our own views about the reasons which gave us financial eminence may well be coloured by national and patriotic prejudice, but when we take the opinion of a German we may be pretty sure that it is not warped by any predisposition in favour of English character and achievement.

A little book published this year by Messrs. Macmillan and Co., entitled "England's Financial Supremacy," contains a translation of a series of articles from the *Frankfurter Zeitung*, and from this witness we are able to get some information which may be valuable, and is certainly interesting.

The basis of England's financial supremacy is recapitulated as follows by this devil's advocate:—

"The influence of history, a mighty empire, a cosmopolitan Stock Exchange, intimate business connections throughout the whole world, cheap money, a free gold market, steady exchanges, an almost unlimited market for capital and an excellent credit system, an elastic system of company legislation, a model Insurance organisation and the help of Germans, these are the factors that have created England's financial supremacy. Perhaps we have omitted one other factor, the errors and omissions of other nations."

Coming closer to detail, our critic says, with regard to the international nature of the business done on the London Stock Exchange:—

"In recent years London had almost lost its place as the busiest stock market in the world. New York, as a rule, Berlin on many occasions, could show more dealings than London. But there was no denying the international character of its business. This was due to England's position of company promoter and money lender to the world; to the way in which new capital was issued there; to its Stock Exchange rules, so independent of legislative and Treasury interference; to the international character of its Stock Exchange members, and to the cosmopolitan character of its clients."

On the subject of our Insurance business and the fair-mindedness and quickness of settlement with

which it was conducted, we can cite the same witness as follows :—

" Insurance, again, represented by the well-known organisation of Lloyds, which in form is something between a stock exchange and a co-operative partnership, is nowhere more elastic and adaptable than in London. It must be said, to the credit of Lloyds, that anyone asking to be insured there was never hindered by bureaucratic restrictions, and always found his wishes met to the furthest possible extent. The agencies of Lloyds abroad are also so arranged that both the insured and the insurer can have their claims settled quickly and equitably."

But one of the most remarkable tributes to a quality with which Englishmen are seldom credited, and one of the frankest confessions of a complete absence of this quality in our German rivals, is contained in the following passage :—

" A further bad habit, harmful to our economic development, is narrow-mindedness. This, too, is very prevalent in Germany—and elsewhere as well. And this is not surprising. Even among the generation which is active to-day, the older members grew up at a time when possibilities of development were restricted and environment was narrow. With commendable foresight many of these older men have freed themselves from this petty spirit, and are second to none in enterprise and energy. Germany can be as proud of its ' captains of industry ' as America itself. But many commercial circles in Germany are still unable to free themselves from these shackles. The relations between buyer and seller are still often disturbed by petty quibbling. In those industries where cartels and syndicates have not yet been formed, too great a rôle is played by dubious practices of many kinds, by infringements of payment stipulations, by unjustifiable deductions, etc., while, on the other hand, the cartels are often too ruthless in their action.

In this field we have very much to learn from the English business man. Long commercial tradition and international business experience have taught him long ago that broad-mindedness is the best business principle. Look at the English form of contract, the methods of insurance companies, the settlement of business disputes! You will find no narrow-mindedness there. Tolerance, another quality which the German lacks, has been of great practical advantage to the Englishman. Until recently the City has never resented the settlement of foreigners, who were soon able to win positions of importance there. Can one imagine that in Berlin an Italian or a South American, with very little knowledge of the German language, would be not only entrusted with the management of leading banks and companies, but would be allowed in German clubs to lay down—in their faulty German—the law as to the way in which Germany should be developed? Impossible! Yet this could be seen again and again in England, and the country gained greatly by it. If the English have now developed a hatred of the foreigner, it only means that the end of England's supremacy is all the nearer."

According to our German critic the great fabric that has been built up on these characteristics and qualities is threatened with ruin by the war; and the heritage which we are supposed to be losing is to fall, by some process which is not made very clear, largely into the hands of Berlin. In order that we may not be accused of taking the laudatory plums out of this German pudding and leaving out all criticisms and accusations, let us quote in full the passage in which he dances in anticipation on London's corpse:—

"Let us sum up. England's reputation for honest business dealing and for trustworthy administration has

suffered. Her insular inviolability has been put in question. The ravages of war have undermined the achievements of many generations. Her free gold market has broken down. The flow of capital towards London will fall off, for those who cannot borrow there will no longer send deposits. The surplus shown in her balance-sheet will contract. Foreign trade will also decrease. Hand in hand with this fall, free trade, that mighty agent in the development of England's supremacy, will, in all probability, give place to protection. Stock Exchange business will grow less. Rates of interest will be permanently higher."

How much truth is there in all this? Has our reputation for honest dealing and for trustworthy administration suffered? Surely not in the eyes of any reasonable and unprejudiced observer. In the course of the greatest war in history, fought by Germany with weapons which have involved the violation of the most sacred laws of humanity and civilisation, England has acted with a respect for the interests of neutrals which has been severely criticised by impatient observers at home. As for our "insular inviolability" having been put in question, it certainly has not, so far, suffered any serious damage. Our Fleet has defended us from invasion with complete success, and the damage done by marine and aerial raiders to our property on shore is negligible. Our free gold market is said to have broken down. The proof of the pudding is in the eating. Germany, when the war began, immediately relieved the Reichsbank from any obligation of meeting its notes in gold, and frankly went on to a paper basis. England has already shipped well over 200 millions in gold to

America to finance her purchases there and those of her Allies.

It may be true that capital will not flow to London if London is not in a position to lend, but we see no reason why London should not be able to resume her position as an international money lender, not perhaps immediately on the declaration of peace, but as soon as the aftermath of war has been cleared away and the first few months of difficulty and danger have been passed. The prophecy that foreign trade will decrease may also be true for a time owing to the destruction of merchant shipping that the war is causing. This possibility, however, may be remedied between now and the end of the war if the great programmes of merchant shipbuilding which have been undertaken by the British and American Governments are duly carried out. In any case, even if foreign trade decreases, there is no reason whatever to expect that England's will decrease faster than that of other nations.

In all these problems we have to look for the relative answer and to consider not whether England has suffered by the war, for it is most obvious that she has, but whether she will have been found to have suffered more than any competitor who may threaten her after-war position.

"Free trade," says our German Jeremiah, "that mighty agent in the development of England's supremacy, will, in all probability, give place to protection." We venture to think that it will be recognised that the Free Trade policy of the past gave us a well-distributed wealth which was an invaluable

weapon in time of war, and that any attempt to impose import duties when peace comes will be admitted, even by the most ardent Tariff Reformers, as untimely when there is likely to be a world-wide scramble for food and raw materials, and the one object of every nation will be to get them wherever they can and as cheaply as they can.

If Stock Exchange business will be less, though this does not by any means follow, there is no reason why it should be relatively less here than in other centres. As to rates of interest being permanently higher, the same answer applies. It may be true, but there is no reason why they should be relatively higher in London than elsewhere ; and, if they are high, it will be because there will be a great demand for capital, which will mean a great trade expansion ; both in the provision of capital and in meeting the demands of trade expansion England will be doing what she has done with marked success in the past and can, if she works in the right way now and after the war, do again with equal and still greater success.

There is, however, a danger that threatens our financial position after the war, on the subject of which our German critic is discreetly silent, because that danger threatens the position of Germany very much more emphatically. It consists in the way in which our Government is at present meeting the needs of war finance, not by compelling economy on the civilian population through taxation and borrowing direct from investors, but by manufacturing currency for the purposes of the war by means of the printing press and the banking machinery. The

effect of this policy is seen in the enormous mass of Treasury notes with which the country has been flooded. Their total is now nearly 180 millions or perhaps 100 millions more than the gold which they were originally designed to replace.

It is also to be seen in the great increase in banking deposits which has been a feature of our financial history since the war began. Some people regard this feature as a phenomenal proof of the growth of our wealth during the war. I am afraid there is little foundation for this pleasant assumption, for these new deposits have been called into being by the banks subscribing to Government securities, whether War Loan, Treasury Bills, Exchequer Bonds or Ways and Means advances or lending their customers the wherewithal to do so. By this process the balance-sheets of the banks are swollen on both sides, by the Government securities and advances to customers among the assets, against which the banks create new deposits, so giving the community as a whole the right to draw more cheques.

Every time the bank makes an advance it gives the borrower a credit in its books, that is to say, the right to draw cheques to that amount ; the borrower draws on the credit and hands it to any one to whom he owes money ; but as long as the advance is outstanding there will be a deposit out against it in the books of some bank or another.

It is an easy way for the Government to finance the war by getting the banks to manufacture money for it. Nobody feels any poorer for the process, in fact, those who have new money in their pockets or

in their bank balance feel richer, but the result of thus multiplying currency without any increase in the supply of goods and services to be bought inevitably helps the rise in prices which makes the war costly, puts the burden of it on to the wrong shoulders, and likewise cheapens the value of the English pound as measured in other currencies. This is why the evils involved by this process become so relevant to the question now at issue.

If the Government is allowed to go on financing the war by increasing the currency with the very reluctant help of the bankers, the difficulties of maintaining our gold standard and keeping the exchanges in favour of London will be very greatly magnified when the war is over and our gold reserves are no longer protected by the submarines and the high cost of shipping gold that they produce. It therefore follows that all who have the true interests of the City at heart should use all the influence they can to force the Government to adopt a sounder financial policy before it is too late.

It is true that our war finance has hitherto been sounder than that of any other warring Power, but it has fallen very short if we apply the rough test of the proportion of the cost of war borne out of taxation and compare our performance with the results achieved by our ancestors in the Napoleonic and Crimean wars.

If we have done better than France, Italy, Russia and Germany in this respect, it must also be remembered that the financial prestige which these countries had to maintain was not nearly so great

and well established as ours, with the possible exception of France; and France, being exposed to the ravages of a ruthless invader, was in a position which put special obstacles in the way of the canons of sound finance.

If, then, there are certain dangers that threaten our financial position when the war is over, we must remember, on the other hand, that the war has already done a great deal to maintain our financial prestige and raise it to a height at which it never stood before.

When the war began we were expected to finance the Allies, to keep the seas clear and put a small Expeditionary Force to support the left flank of the French Army, and to do these things during a contest which was expected by the consensus of expert opinion to last not more than a few months. All these things we accomplished, and we were the only Power at war which did actually accomplish all that it was expected and asked to do. More than that, we also undertook a great task which was not in our programme; we created a great army on a Continental scale, and, at the same time, continued to carry out the other tasks which had been assigned to us.

All these things we did, and that we should have done them was evidence of economic strength and adaptability which have astonished the world. To have financed the Allies and ourselves as long as we did would have been comparatively easy if our population could have been left at work to turn out the stuff and services, the provision of which are

implied by financing ; but for us to have been able to do it and at the same time to improvise an army which is now consistently and regularly beating the Germans is an achievement which will inevitably raise the world's opinion of our economic strength, on which financial prestige is ultimately based.

But, as it has been said, in discussing this question we have to look at it all the time from the relative point of view. How will our prestige be when the war is over, not as compared with what it was before the war, but as compared with what any other rival in any other part of the world can show ? Here we have to acknowledge at once, freely and frankly, that, as compared with New York, we shall have gone backward.

America will have been enormously enriched by the war, which we shall certainly have not. America will have been opening up channels of international trade and international finance, and so New York will have been gaining at the expense of London. It is certain that when the war is over America's dependence upon London for credits against the shipments of goods to and from her shores will have been very greatly lessened, if not altogether a thing of the past.

This change would have happened any way, war or no war, but it has been greatly quickened by the war. Before the war America was already making arrangements, under her new banking system, to promote the machinery for acceptance and discount, in order that goods sent to her from foreign countries should be financed by bills drawn on

American banks and houses in dollars instead of on English banks and houses in sterling.

Apart from this development, which would have happened in any case, it remains to be seen how far New York will be in a position to act as a rival of London as the world's financial centre. The internal resources and potentialities of America are so enormous, and there is such a vast amount of work to be done in developing them and bringing them to full fruition, that it does not at all follow that America will yet be inclined to take the position in international trade and finance which will one day surely be hers, when she has done all the work that is waiting to be done in her own back premises.

America has a new banking and monetary system on trial which has met the difficult problems of the war with great success. These problems, however, are not nearly as complicated and various as those which are likely to arise in time of peace. When a nation is turning out an enormous amount of goods for which the rest of the world is prepared to pay any price, her finance is a comparatively simple business. Even now, when America has assumed the duty of financing a large number of Allies impoverished by three years of war which have been enriching her, she is still simplifying the problem by restricting her advances to the payment for goods bought in America.

That New York will be greatly strengthened by the war, which has brought masses of American securities back to the country of origin and has put into the hands of American bankers and investors

large blocks of European promises to pay, is as clear as noonday; but whether when the war is over New York will care to be bothered much with problems of international finance remains to be seen. In the first place, the claims of her own country upon her financial resources will be insatiable and imperative. In the second place, the business of international finance is carried out on very finely cut terms; and the Americans being accustomed to the fat rates of profit which business at home has given them may not care to devote much attention to the international market, in which the risks are big, the turnover is enormous and the profits very finely cut. It has been remarked by a shrewd observer that the Americans will never do business for a thirty-second.

In the third place, it must be remembered that the geographical position of London is more favourable than that of New York as a world centre, as the world is at present constituted. England, anchored off the coast of Europe, is clearly marked as the depôt for the entrepôt trade of the Old and New Worlds. New York is clearly marked as the centre for the trade of the Western hemisphere, and it is likely enough that New York and London, acting together as the financial chiefs of the two hemispheres, may be gradually united into what is practically one market by the growing ties of mutual interest.

With regard to the position of other possible rivals to London's position, it need only be said that they have certainly been weakened much more

rapidly than has London during the course of the war. Paris, threatened by the near approach of an invading foe, has inevitably suffered much more severely than London, and is likely to take longer in recovering the great position as a provider of capital which was given to her by the thrift of the average French citizen. Every one expects with confidence to see, when the war is over, a miraculous recovery in France produced by the same spirit which worked miracles after the war of 1871, aided and abetted by the subsequent improvement in man's control over the forces of nature, and also by the deep and world-wide sympathy which all will feel for France as the champion of freedom who has suffered most severely in its causé during the war. But it is impossible to expect, after what France has suffered, that she will be, for some time, in a position seriously to challenge London as a financial rival. All Englishmen will hope that the day when she will be in a position to challenge us again will come quickly.

As to Berlin, the only other possible rival to London in Europe, very little need be said. The German authority quoted above has already shown some of the difficulties with which Berlin has to struggle. He spoke of the narrow-mindedness of German finance, of the "petty quibbling" which often disturbs the relations between buyer and seller, of the "dubious practices of many kinds, infringements of payment stipulations, unjustifiable deductions," etc., and the "ruthless" action of the cartels. He acknowledges that though Germany had a gold

standard " too much anxiety used to be shown when the gold export point was reached," and that " it was also feared that to export gold would incur the wrath of the Reichsbank."

With these disadvantages to struggle against, quoted from the mouth of a German observer, Germany has also succeeded by her ruthless policy during the war in earning the deep hostility of the greater part of mankind. Sentiment probably enters into business relations a good deal more than most business men admit, and for any country to set out to gain the leadership in trade and finance by outraging the feelings of most of its possible customers is an extraordinary piece of stupidity.

It seems, then, that apart from the relative weakening of London as compared with New York, there is very little need for us to fear any serious change in England's financial position after the war as long as the Government's faulty finance is not allowed too seriously to endanger the position of our gold standard. It is true that we shall not benefit, as much as we undoubtedly have in the past, from the " help of Germans " in developing our finance. But indirectly the Germans will still be helping us by the great stimulus that the war will have given us towards efficiency and hard work.

What we have to do in order to secure London's position after the war is to restore as soon as we can the system that had established it in the century before the war. We have to show the world that, far from any intention to abandon Free Trade, we mean to take a long step forward along the line of

international activity which has been the source of our greatness in the past. We want, as soon as possible, to get back that freedom from Government control which has given us such elasticity and adaptability to our money market, our Stock Exchange and our Insurance business. A certain amount of Government control will inevitably have to continue for a time after the war, but the sooner we rid ourselves of it the sooner we shall restore to the London money market those qualities which, after the reputation that it has for honesty, soundness and straight dealing, were most helpful in building up its eminence.

Above all, we have to work hard both in finance and industry and commerce. Finance, which is the machinery for handling claims for goods and services, can only be active and effective if industry and commerce are active and effective behind it, turning out the goods and services to meet the claims that finance creates. A great industrial and commercial output, with severe restriction of unnecessary consumption so that a great margin may go into capital equipment, will soon repair the ravages of war, bring down the price of credit and of capital and make London once more the place in which these things are most cheaply and freely to be bought.

Finally, if we want to restore London as a place in which all the financial transactions of the world were centred, we must remember that we cannot do so if we restrict the facilities given to foreigners to come here and settle and do business. It is not possible to be an international centre with an insular sentiment.

III

WAR FINANCE AS IT MIGHT HAVE BEEN—I

November, 1917

Financial Conditions in August, 1914—No Scheme prepared to meet the Possibility of War—A Short Struggle expected—The Importance of Finance as a Weapon—Labour's Example—The Economic Problem of War—The Advantages of Direct Taxation—The Government follows the Path of Least Resistance—The Effect of Currency Inflation.

A LEGEND current in the City says that the Imperial War Committee, or whatever was the august body entrusted with the task of thinking out war problems beforehand, had done its work with regard to the Army and Navy, transport and provision, and everything else that we should want for the war, and were going on to the question of finance next week, when the war intervened. Whatever may be the truth of this story, the events of the war confirm the opinion that if it was not true it ought to have been. We are continually accused of not having been ready for the war ; but, in fact, we were quite ready to do everything that we had promised to do with regard to military and naval operations. Our Navy was ready in its place in the fighting line, and

the dispatch with which our Expeditionary Force was collected from all parts of the kingdom, and shipped across to France, was a miracle of efficiency and practical organisation. It is true that we had not got an Army on a Continental scale, but it was no part of our contract that we should have one. The fighting on land was in those days expected to be done by our Allies, assisted by a small British force on the left flank of the French Army. That British force was duly there, and circumstances which were quite unforeseen made it necessary for us to undertake a task which was no part of our original programme and create an Army on a Continental scale, in addition to doing everything that we had promised beforehand to a much greater extent than was in the bargain.

But in finance there was no evidence that any thought-out policy had been arrived at in order to make the best possible use of the nation's economic resources for the war when it came. The acute crisis in the City which occurred in August, 1914, was a minor matter which hardly affected the subsequent history of our war finance except by giving dangerous evidence of the ease by which financial problems can be apparently surmounted by the simple method of creating banking credits. That crisis merely arose from the fact that we were so strong financially, and had so great a hold upon the finance of other countries in the world, that when we decided, owing to stress of war, to leave off lending to foreigners and to call in loans that we had made by way of accepting and bill-discounting

arrangements, the whole machinery of exchange broke down because from all over the world the market in exchange went one way. Everybody wanted to buy bills on London, and there were no bills to be had.

There was also the internal problem which arose because some of the public and some of the banks took to the evil practice of hoarding gold just at the wrong moment, and consequently there was no available supply of legal tender currency except in the shape of Bank of England notes, the smallest denomination of which is £5. It is known that our bankers had long before pointed out to the Treasury that if ever a banking crisis arose there would, or might be, this demand for a paper currency of smaller denominations than £5 ; this suggestion got into a pigeon-hole at the Treasury and was deep under the dust of Whitehall by the time experience proved how big a gap in our financial armour had been made by its neglect. If the £1 notes, with which we are now so familiar, had been ready when the war broke out, or, still better, if the Bank of England had been empowered and instructed to have an issue of its own £1 notes ready, it may at least be contended that the moratorium, which was so bad a financial beginning of the war, might have been avoided.

But this opening crisis was a short-lived matter, and was promptly dealt with, thanks to the energy and courage of Mr Lloyd George, who was then Chancellor of the Exchequer, and saw that things had to be done quickly, and took the advice of the

City as to what had to be done. The measures then employed erred, if at all, on the side of doing too much, which was certainly a mistake in the right direction if in any. What is much more evident is the fact that not only had there been no attempt to provide against just such a jolt to our financial machine as took place when the war began, but that, quite apart from the financial machinery of the City, no reasoned and thought-out attention had been given to the great problems of governmental finance which war on such a scale brought with it. There is, of course, the excuse that nobody expected the war to be on this scale, or to last so long. The general view was that the struggle would be over in a few months, and must certainly be so if for no other reason because the economic strain would be so great that the nations of Europe could not stand it for a long time. On the other hand, we must remember that Lord Kitchener, whom most men then regarded as representing all that was most trustworthy in military opinion, made arrangements from the beginning on the assumption that the war might last for three years. So, while some excuse may be made for our lack of financial foresight, it does seem to have been the duty of those whose business it is to manage our finances to have thought out a complete scheme to be adopted in case of war if at any time we should be involved in one on a European scale. Instead of which, not only would it appear that no such endeavour had been made by our Treasury experts before the war, but that no such endeavour has ever been made by them since

the war began. All through the war's history many of the country's mistakes have been based on the encouraging conviction that the war would be over in the next six months. This conviction is still cherished to this day, and there can be no doubt that if those who cherish it hold on to it long enough they will come right some day.

But if delusions of this kind may be fairly excused in the man in the street, they do not seem to be any excuse for those who are responsible for our finance for their total lack of a thought-out scheme at the beginning of the war, and their total failure to produce one as the war went on. We have financed the war by haphazard methods, limping along the line of least resistance. We are continuing to do so, and we may do so to the end, though there are now growing signs of an impatience both among the property-owning classes and others of the system by which we are financing the war by piling up debt and manufacturing banking credits.

The objections to the policy on the part of the "haves" and the "have nots" are, of course, different, but as they both converge to the same point, namely, to the reform of our system of war finance, it is possible that they may in time have the effect of shaking even the confidence of our politicians and officials in the haphazard and slipshod methods which would long ago have produced financial disaster if it had not been for the great financial strength of the country.

Finance is an enormously important weapon in the hands of our rulers for guiding the economic

activities of the people. This is so even in peace time to a certain extent, though the revenue then collected is so small an item in the total national income that it counts for much less than in war, when the power that the Government can wield by its policy in taxation and borrowing might have been all-powerful in keeping the nation on the right lines in the matter of spending and keeping down the cost of the war, and in maintaining our financial staying power to a far greater extent than has actually been done.

It is easy, as they say on the Stock Exchange, to job backwards, and it is also easy, and perhaps rather unprofitable, to hazard opinions about what would have happened if things had been otherwise. Nevertheless, when we look back on the spirit of the country as it was in those early days of the war, when the violation of Belgium had sent a chivalrous thrill through the hearts of all classes in the country, when we all recognised that we were faced with the greatest crisis in our history, that our country and the future of civilisation were about to be tested by the severest strain ever applied to them, that the life and fortune of the individual did not count, but that the war and victory were the only interests that any one had a right to consider—when one remembers all these things, and the use that a wise financial policy might have made of them, it is impossible to avoid the conclusion that the history of the war in this country and its social and political effects might have been something much finer, much cleaner and more noble if only the weapons of finance

had been more boldly and wisely used. It is not a good thing to indulge in high-falutin' on this subject. It is absurd to suppose that the war suddenly turned us all into plaster saints at the beginning, and that we might have continued so to the end if the State had dealt with our money in a proper way. But without setting up any such idealistic arguments as these, looking back on those early days of the war, one can still remember the thrill of earnestness and of eagerness for self-sacrifice which has since then given way lamentably to war profiteering, war strikes, and a general struggle among many classes of the community to make as much as possible out of the war, merely because our financial leaders have never really put the country's financial problem properly before the country.

We were not plaster saints, but we were either idealistic and perhaps foolish people who attached great importance to the freedom and security of small nations and all those items in the programme of idealistic Radicalism, or else we were good, red-hot, true-blue Jingoes with a hearty hatred for Germany, and enjoyed the thought that the big fight which we had long foreseen between the two countries was at last going to be fought out. Or, again, we were just commonplace people who did not much believe in idealistic Radicalism or anti-German bitterness, but saw that the whole future of our country was at stake, and were prepared to do anything for it. A fine example was set us in those days by the Trade Union leaders. The industrial world was seething with discontent. The

Suffragettes in London and the Carsonites in Ireland had shown us how much could be done by appeals to physical force in a lazy-minded community ; and hints of industrial revolution, with great organised strikes, which were going to tie up the transport industry of the country were in the air. And then, when the war came, the Labour leaders said, " No strikes until the war is over. Our country comes first."

This was the lead given to the country by those down at the bottom, who had the least to lose, and whose patriotism during the course of the war has frequently been questioned. At the top the financial and property-owning classes, having been saved by Mr Lloyd George's able adroitness from a bad crisis in the City, were entirely tame, and would have suffered anything in the way of taxation or financial conscription if the need for it had been properly put before them.

It is almost amusing to remember now that in those early days of the war the shareholders in Home Railway companies were thought lucky. The Government were taking the railways over, and were guaranteeing that their proprietors should receive the same dividends as they had had before the war. Such was the view in financial and property-owning circles of results of war that, so far from any expectation of the huge profits which war has put into the pockets of certain classes, they were only too thankful if they could be assured that their gross incomes were not going to be reduced.

Such was the spirit with which the Government of that day had to deal. A spirit in all classes

earnestly patriotic, and so thoroughly frightened of the economic consequences of the war that it would have been ready to face any sacrifices that the Government had asked of it. How, then, would the Government have dealt with this spirit if it had taken the trouble really to think out the problem of war finance on a long view instead of proceeding along a haphazard line, adjusting peace methods to war without any consideration as to their adequacy? If the problem had been really thought out beforehand the Government must have seen clearly that the real economic problem in war-time is not merely a question of raising money, since that can at any time be done easily by means of a printing-press, but of diverting the industrial energy of the nation from peace to war purposes, that is to say, transferring from the enjoyment of the individual citizen the goods and services that used to contribute to his comfort and amusement, and turning them over to the provision of the things needed for the war. War's needs can only be met out of the current production of the world as it is at present. All the warring powers begin a war with certain accumulated war stores consisting of battleships, ammunition, guns and all other forms of war material. Apart from these stores with which they begin, the whole work of providing the armies with the fighting materials that they require, and the food and clothes that they consume, has to be done during the course of the war, that is to say, out of the current production of the moment.

Therefore the real economic problem that any

Government has to face in war-time is that of inducing its citizens to reduce their purchase of goods and services, that is to say, to spend less, so that all the things required for the Army and Navy may be obtained by the Government. It is true that some of the goods and services required for carrying on war can be obtained from foreign countries by any belligerent which is able to communicate with them freely. In that case the current production of the foreigner can be called in to help. But this can only be done if the warring country is able to ship goods to the foreigner in payment for what it buys, or if it is able to obtain a loan from the foreigner, or some other foreign country, in order to pay for its purchases abroad, or again, if, as in our case, it holds a large accumulation of securities which foreign countries are prepared to take in exchange for goods that they send for the purposes of the war. By these two last-named processes, raising money abroad, and selling securities to foreign nations, the warring country impoverishes itself for the future. When it borrows abroad it pledges itself to export goods and services in future to meet interest and sinking fund on the money so raised, so getting no goods and services in return. When it ships its accumulated wealth in the form of securities it gives up for the future any claim to goods and services from the debtor country which used to come to it to meet interest and redemption. It is only by shipping goods in return for goods imported for the war that a country can keep its financial staying-power on an even keel.

Thus the problem which a statesman who had thought out the economics of war beforehand would have recognised as the keystone of his policy, would have been that of diverting the activities of the country from providing itself with comforts and amusements to turning out goods required for war, and of doing so with the least possible friction, the least possible alteration in the economic equilibrium of the country, and, above all, with the least possible cost to the national finances. We arrive at the true aspect of this problem more easily if we leave out the question of money altogether and think of it in units of energy. When a nation goes to war it means to say that it has to apply so many units of energy to the business of fighting, and to provide the fighters with all that they need. If at the beginning of the war its utmost capacity of output was, to mention merely a fanciful figure, a thousand million units of energy, and if it was clear that the fighting forces of the country would need for their proper maintenance five hundred million units of energy, then it is clear that the nation's ordinary consumption of goods and services would have to be reduced to the extent of five hundred millions of units of energy, which would have to be applied to the war, that is, assuming that its possible output remained the same.

In other words, the spending power of the citizens of the country had to be reduced so that the industrial energy that used to go into meeting their wants might be made available for the purposes of the fighting forces. Now what was the straightest,

simplest and cleanest way of bringing about this reduction in buying power on the part of the ordinary citizen which has been shown to be necessary for the purposes of war finance? Clearly the best way of doing it is by taxation equitably imposed. When the State taxes, it says in effect to the citizens, "Your country needs certain goods and services, you therefore will have to go without those goods and services, and the simplest way to make you do this is to take away your money and so ration your buying power. Whatever is needed for the Army and Navy will be taken away from you by taxation, and the result of this will be that, instead of your indulging in comforts and luxuries, to the extent of the war's needs the Government will use your money for paying for what is needed for the Army and Navy."

If such a policy had been carried out the cost of the war to the community would have been enormously cheapened. There need have been no general rise in prices because there would have been no increase in demand for goods and services. Anything that the Government spent would have been counter-balanced by decreased spending by the individual; any work that the Government needed for the war would have been counter-balanced by a reduction in demand for work on the part of individual citizens. There would have been no multiplication of currency owing to enormous credits raised by the Government; there would have been merely a transfer of buying power from individuals to the State. The process would have been gradual,

there need have been no acute dislocation, but as the cost of the war increased, that is to say, as the Government needed more and more goods and services for its prosecution, the community would gradually have shed one after another the extravagances on which it spent so many hundreds of millions in days before the war. As it shed these extravagances the labour and energy needed to produce them would have been automatically transferred to the service of the war, or to the production of necessaries of life. By this simple process of monetary rationing all the frantic appeals for economy, and most of the complicated, tangled problems raised by such matters as Food Control or National Service would have been avoided.

But, it may be contended, this is setting up an ideal so absurdly too high that you cannot expect any modern nation to rise up to it. Perhaps this is true, though I am not at all sure that if we had had a really bold and far-sighted Finance Minister at the beginning of the war he might not have persuaded the nation to tackle its war problem on this exalted line. At least it can be claimed that our financial rulers might have looked into the history of the matter and seen what our ancestors had done in big wars in this matter of paying for war costs out of taxation, with the determination to do at least as well as they did, and perhaps rather better, owing to the overwhelming scale of modern financial problems. If they had done so they would have found that both in the Napoleonic and the Crimean wars we paid for nearly half the cost of the war out

of revenue as they went on, whereas in the present war the proportion that we are paying by taxation, instead of being 47 per cent., as it was when our sturdy ancestors fought against Napoleon, is less than 20 per cent.* Why has this been so? Partly, no doubt, owing to the slackness and cowardice of our politicians, and the apathy of the overworked officials, who have been too busy with the details of finance to think the problem out on a large scale. But it is chiefly, I think, because our system of taxation, though probably the best in the world, involves so many inequities that it cannot be applied on a really large scale without producing a discontent which might have had serious consequences on our conduct of the war.

It is not possible nowadays, now that the working classes are conscious of their strength, to apply taxation to ordinary articles of general consumption with anything like the ruthlessness which in former days produced such widespread misery. Indirect taxation of this kind carries with it this inherent weakness that its burden falls most heavily on those who are least able to bear it, consequently it is bound to break in the hand of those who attempt to apply it with anything like vigour to a community which is prepared to stand up for fair treatment. A tax on bread or salt obviously hits the wage-earner at 30*s.* a week infinitely harder than it hits the millionaire, and so the country would not tolerate taxes on bread or salt. Direct taxes, such

* See *Economist*, August 4, 1917, p. 151.

as Income Tax and Death Duties, have this enormous advantage, that they can really be regulated so as to press with continually increasing severity upon those who are best able to bear them. Unfortunately our Income Tax is still so unjustly imposed that it was clearly impossible to make full use of it without its being first reformed. That two men, each earning £1000 a year, should pay the same Income Tax, in spite of one having a wife and five children, while the other is a careless bachelor, is such a blot upon this otherwise excellent tax that it is generally agreed that the present rate of 5*s.* is as high as it can be made to go unless some reform is introduced into its incidence. The need for its reform is made the excuse for a sparing use of the tax, and we have been on several occasions assured that, as soon as the war is over, this reform will be set about.

In the meantime the Government falls back on finding about 80 per cent. of its requirements of the war on a system of borrowing. In so far as the money subscribed to its loans is money that is being genuinely saved by investors this process has exactly the same effect as taxation, that is to say, somebody goes without goods and services and hands over his power to buy them to the State to be used for the war. Borrowing of this kind consequently does everything that is needed for the solution of the immediate war problem, and the only objection to it is that it leaves later on the difficulties involved by raising taxes when the war is over, and economic problems are much more complicated in times of peace than in war, for meeting the interest and

redemption of debt. But, in fact, it is well known that by no means all that the Government has borrowed for war purposes has been provided in this way. Much of the money that the Government has obtained for war purposes has been got not out of genuine savings of investors, but by arrangements of various kinds with the banking machinery of the country, or by the simple use of the printing-press, with the result that the Government has provided itself with an enormous mass of new currency which has not been taken out of anybody else's pocket, but has been manufactured by or for the Government.

The consequence of the profligate use of this dishonest process is that general rise in prices, which is in effect an indirect tax on the necessaries of life, involving all the injustice and ill-feeling which arises from such a measure. It is inevitable that the working classes, finding themselves subjected to a rise in prices, the cause of which they do not understand, but the result of which they see to be a great decrease in the buying power of their wages, should believe that they are being exploited by profiteers, that the rich classes are growing richer at their expense out of the war, and that they and the country are being bled by a set of unpatriotic capitalist blood-suckers. It is also natural that the property-owning classes, who find themselves paying an Income Tax which they regard as extortionate, should consider that the working classes by their continuous demands for higher wages to meet higher cost of living, are trying to exploit the country in their own interests in a time of national crisis, and

displaying a most unedifying spirit. The social result of this evil policy of inflation, in embittering class against class, is a matter which it is difficult to exaggerate. Some people think that it was inevitable. This is too wide a question to be entered into now, but at least it must be contended that if it is inevitable the extent to which it is being practised might have been very greatly diminished.

Do we mean to go on to the end of the war with this muddling policy of bad finance? If we still insist on believing that the war cannot last another six months, and there is therefore no need to pull ourselves up short financially and put things in order, then we certainly shall do so. But we should surely recognise that there is at least a chance that the war may go on for years, that if so our present financial methods will leave us with a burden of debt which is appalling to consider, and that in any case, whether the war lasts another six months or another six years, a reform of our financial methods is long overdue, is inevitable some time, and will pay us better the sooner it is set about.

IV

WAR FINANCE AS IT MIGHT HAVE BEEN—II

December, 1917

The Changed Spirit of the Country—A Great Opportunity thrown away—What Taxation might have done—The Perils of Inflation—Drifting stupidly along the Line of Least Resistance—It is we who pay, not "Posterity."

In the November number of *Sperling's Journal* I dealt with the question of how our war finance might have been improved if a longer view had been taken from the beginning concerning the length of the war and the measures that would be necessary for raising the money. The subject was too big to be fully covered in the course of one article, and I have been given this opportunity of continuing its examination. Before doing so I wish to remind my readers once more of the great difference in the spirit of the country with regard to financial self-sacrifice in the early days of the war and at the present time, after three years of high profits, public and private extravagance, and successful demands for higher wages have demoralised the public temper into a belief that war is a time for making big profits and earning big wages at the expense of the community. In the early days the spirit of the country was very

different, and it might have remained so if it had been trained by the use made of public finance along the right line. In the early days the Labour leaders announced that there were to be no strikes during the war, and the property-owning classes, with their hearts full of gratitude for the promptitude with which Mr Lloyd George had met the early war crisis, were ready to do anything that the country asked from them in the matter of monetary sacrifice. Mr Asquith's grandiloquent phrase, "No price is too high when Honour is at stake," might then have been taken literally by all classes of the community as a call to them to do their financial duty. Now it has been largely translated into a belief that no price is too high to exact from the Government by those who have goods to sell to it, or work to place at its disposal. In considering what might have been in matters of finance we have to be very careful to remember this evil change which has taken place in the public spirit owing to the short-sighted financial measures which have been taken by our rulers.

Thus, when we consider how our war finance might have been improved, we imply all along that the improvements suggested should have been begun when the war was in its early stages, and when public opinion was still ready to do its duty in finance. The conclusion at which we arrived a month ago was that by taxation rather than by borrowing and inflation much more satisfactory results could have been got out of the country. If, instead of manufacturing currency for the prosecution of the war, the Government had taken money from the citizens

either by taxation or by loans raised exclusively out of real savings, the rise in prices which has made the war so terribly costly, and has raised so great a danger through the unrest and dissatisfaction of the working classes, might have been to a great extent avoided, and the higher the rate of taxation had been, and the less the amount provided by loans, the less would have been the seriousness of the problem that now awaits us when the war is over and we have to face the question of the redemption of the debt.

In this matter of taxation we have certainly done much more than any of the countries who are fighting either with us or against us. Germany set the example at the beginning of the war of raising no money at all by taxation, puffed up with the vain belief that the cost of the war, and a good deal more, was going to be handed over to her in the shape of indemnities by her vanquished enemies. This terrible miscalculation on her part led her to set a very bad example to the warring Powers, and when protests are made in this country concerning the low proportion of the war's costs that is being met out of taxation it is easy for the official apologist to answer, "See how much more we are doing than Germany." It is easy, but it is not a good answer. Germany had no financial prestige to maintain; the money that Germany is raising for financing the war is raised almost entirely at home, and she rejoices in a population so entirely tame under a dominant caste that it would very likely be quite easy for her, when the war is over, to cancel a large part of the

debt by some process of financial jugglery, and to induce her tame and deluded creditors to believe that they have been quite handsomely treated.

Here, however, in England, we have a financial prestige which is based upon financial leadership of more than a century. We have also raised a large part of the money we have used for the prosecution of the war by borrowing abroad, and so we have to be specially careful in husbanding that credit, which is so strong a weapon on the side of liberty and justice. And, further, we have a public which thinks for itself, and will be highly sceptical, and is already inclined to be sceptical, concerning the manner in which the Government may treat the national creditors. Its tendency to think for itself in matters of finance is accompanied by very gross ignorance, which very often induces it to think quite wrongly; and when we find it necessary for the Chancellor of the Exchequer to make it clear at a succession of public meetings that those who subscribe to War Loans need have no fear that their property in them will be treated worse than any other kinds of property, we see what evil results the process of too much borrowing and too little taxation can have in a community which is acutely suspicious and distrustful of its Government, and very liable to ignorant blundering on financial subjects.

What, then, might have been done if, at the beginning of the war, a really courageous Government, with some power of foreseeing the needs of finance for several years ahead if the war lasted, had made a right appeal to a people which was at

that time ready to do all that was asked from it for the cause of justice against the common foe? The problem by which the Government was faced was this, that it had to acquire for the war an enormous and growing amount of goods and services required by our fighting forces, some of which could only be got from abroad, and some could only be produced at home, while at the same time it had to maintain the civilian population with such a supply of the necessaries of life as would maintain them in efficiency for doing the work at home which was required to support the effort of our fighters at the Front. With regard to the goods which came from abroad, either for war purposes or for the maintenance of the civilian population, the Government obviously had no choice about the manner in which payment had to be made. It had no power to tax the suppliers in foreign countries of the goods and services that we needed during the war period. It consequently could only induce them to supply these goods and services by selling them either commodities produced by our own industry, or securities held by our capitalists, or its own promises to pay.

With regard to the goods that we might have available for export, these were likely to be curtailed owing to the diversion of a large number of our industrial population into the ranks of the Army and into munition factories. This curtailment, on the other hand, might to a certain extent be made good by a reduction in consumption on the part of the civilian population, so setting free a larger proportion of our manufacturing energy for the pro-

duction of goods for export. Otherwise the problem of paying for goods purchased from abroad could only be solved by the export of securities, and by borrowing from foreign countries, so that the shells and other war material that were required, for example, from America, might be paid for by American investors in consideration of receiving from us a promise to pay them back some day, and to pay them interest in the meantime. In other words, we could only pay for what we needed from abroad by shipping goods or securities. As is well known, we have financed the war by these methods to an enormous extent ; the actual extent to which we have done so is not known, but it is believed that we have roughly balanced by this process the sums that we have lent to our Allies and Dominions, which now amount to well over 1300 millions.

If this is so, we have, in fact, financed the whole of the real cost of the war to ourselves at home, and we have done so by taxation, by borrowing saved money, and by inflation—that is to say, by the manufacture of new currency, with the inevitable result of depreciating the buying power of our existing currency as a whole. How much better could the thing have been done ? In other words, how much of the war's cost in so far as it was raised at home could have been raised by taxation ? In theory the answer is very simple, for in theory the whole cost of the war, in so far as it is raised at home, could have been raised by taxation if it could have been raised at all. It is not possible to raise more by any other

method than it is theoretically possible to raise by taxation. It is often said, " All this preaching about taxation is all very well, but you couldn't possibly get anything like the amount that is needed for the war by taxation, or even by borrowing of saved money. This inflation against which economic theorists are continually railing is inevitable in time of war because there isn't enough money in the country to provide all that is needed."

This argument is simply the embodiment of the old delusion, so common among people who handle the machinery of finance, that you can really increase the supply of necessary goods by increasing the supply of money, which is nothing else than claims to goods expressed either in pieces of metal or pieces of paper. As we have seen, all that we have been able to raise abroad has been required for advances to our Allies and Dominions, consequently we have had to fall back upon our own home production for everything needed for our own war costs. Either we have turned out the goods at home or we have turned out goods to sell to foreigners in exchange for goods that we require from them. But since we thus had to rely on home production for the whole of the war's needs as far as we were concerned, it is clear that the Government could, if it had been gifted with ideal courage and devotion, and if it had a people behind it ready to do all that was needed for victory, have taken the whole of the home production, except what was wanted for maintaining the civilian population in efficiency, for the purposes of the war.

It is a commonplace of political theory that the Government has a right to take the whole of the property and the whole of the labour of its citizens. But it would not, of course, have been possible for the Government immediately to inaugurate a policy of setting everybody to work on things required for the war and paying them all a maintenance wage. This might have been done in theory, but in practice it would have involved questions of industrial conscription, which would probably have raised a storm of difficulty. What the Government might have done would have been by commandeering the buying power of the citizen to have set free the whole industrial energy of the community for supplying the war's needs and the necessaries of life. At present the national output, which is only another way of expressing the national income, is produced from certain channels of production in response to the expectation of demand from those whose possession of claims to goods, that is to say, money, gives them the right to say what kind of goods they will consume, and consequently the industrial part of the population will produce.

Had the Government laid down that the whole cost of the war was to be borne by taxation, the effect of this measure would have been that everything which was needed for the war would have been placed at the disposal of the Government by a reduction in spending on the part of those who have the spending power. In other words, the only process required would have been the readjustment of industrial output from the production of goods

needed (or thought to be needed) for ordinary individuals to those required for war purposes. This readjustment would have gone on gradually as the war's cost increased. There would have been no competition between the Government and private individuals for a limited amount of goods in a restricted market, which has had such a disastrous effect on prices during the course of the war; there would have been no manufacture of new currency, which means the creation of new buying power at a time when there are less goods to buy, which has had an equally fatal effect on prices; there would have had to be a very drastic reform in our system of taxation, by which the income tax, the only really equitable engine by which the Government can get much money out of us, would have been reformed so as to have borne less hardly upon those with families to bring up.

Mr Sidney Webb and the Fabians have advocated a system by which the basis of assessment for income tax should be the income divided by the number of members of a family, rather than the mere income without any consideration for the number of people that have to be provided for out of it. With some such scheme as this adopted there is no reason why the Government should not have taken, for example, the whole of all incomes above £1000 a year for each individual, due allowance being made for obligations, such as rent, which involve long contracts. For any single individual to want to spend more than £1000 a year on himself or herself at such a crisis would have been recognised, in the early days of the war,

as an absurdity ; any surplus above that line might readily have been handed over to the Government, half of it perhaps in taxation and the other half in the form of a forced loan.

So sweeping a change would not have been necessary at first, perhaps not at all, because the war's cost would not have grown nearly so rapidly. All surplus income above a certain line would have been taken for the time being, but with the promise to repay half the amount taken, so that it should not be made a disadvantage to be rich, and no discouragement to accumulation would have been brought about. By this means the whole of the nation's buying power among the richer classes would have been concentrated upon the war, with the result that the private extravagance, which is still disgracing us in the fourth year of the war, would not have been allowed to produce its evil effects. With the rich thus drastically taxed, the working classes would have been much less restive under the application of income tax to their own wages. We should have a much more freely supplied labour market, and since the rise in prices would not have been nearly so severe, labour's claim to higher wages would have been much less equitable, and labour's power to enforce the claim would have been much less irresistible.

What the Government has actually done has been to do a little bit of taxation, much more than anybody else, but still a little bit when compared with the total cost of the war ; a great deal of borrowing, and a great deal of inflation. By this last-named

method it produces the result required, that of diverting to itself a large part of the industrial output of the country, by the very worst possible means. It still, by its failure to tax, leaves buying power in the hands of a large number of people who see no reason why they should not live very much as usual; that is to say, why they should not demand for their own purposes a proportion of the nation's energy which they have no real right to require at such a time of crisis. But in order to check their demands, and to provide its own needs, the Government, by setting the bankers to work to provide it with book credits, gives itself an enormous amount of new buying power with which, by the process of competition, it secures for itself what is needed for the war. There is thus throughout the country this unwholesome process of competition between the Government on one hand and unpatriotic spenders on the other, who, between them, put up prices against the Government and against all those unfortunate, defenceless people who, being in possession of fixed salaries, or of fixed incomes, have no remedy against rising prices and rising taxation. All that could possibly have been spent on the war in this country was the total income of the people, less what was required for maintaining the people in health and efficiency. That total income Government might, in theory, have taken. If it had done so it could and would have paid for the whole of the war out of taxation.

All this, I shall be told, is much too theoretical and idealistic; these things could not have been

done in practice. Perhaps not, though it is by no means certain, when we look back on the very different temper that ruled in the country in the early months of the war. If anything of the kind could have been done it would certainly have been a practical proof of determination for the war which would have shown more clearly than anything else that "no price was too high when Honour was at stake." It would also have been an extraordinary demonstration to the working classes of the sacrifices that property owners were ready to make, the result of which might have been that the fine spirit shown at the beginning of the war might have been maintained until the end, instead of degenerating into a series of demands for higher wages, each one of which, as conceded to one set of workmen, only stimulates another to demand the same. But even if we grant that it is only theoretically possible to have performed such a feat as is outlined above, there is surely no question that much more might have been done than has been done in the matter of paying for the war by taxation. If we are reminded once more that our ancestors paid nearly half the cost of the Napoleonic war out of revenue, while we are paying about a fifth of the cost of the present war from the same source, it is easy to see that a much greater effort might have been made in view of the very much greater wealth of the country at the present time. I was going to have added, in view also of its greater economic enlightenment, but I feel that after the experience of the present war, and its financing by currency

debasement, the less about economic enlightenment the better.

What, then, stood in the way of measures of finance which would have obviously had results so much more desirable than those which will face us at the end of the war? As it is, the nation, with all classes embittered owing to suspicions of profiteering on the part of the employers and of unpatriotic strikes on the part of the workers, will have to face a load of debt, the service of which is already roughly equivalent to our total pre-war revenue; while there seems every prospect that the war may continue for many half-years yet, and every half-year, as it is at present financed, leaves us with a load of debt which will require the total yield of the income tax and the super-tax before the war to meet the charge upon it. Why have we allowed our present finance to go so wrong? In the first place, perhaps, we may put the bad example of Germany. Then, surely, our rulers might have known better than to have been deluded by such an example. In the second place, it was the cowardice of the politicians, who had not the sense in the early days of the war to see how eager the spirit of the country was to do all that the war required of it, and consequently were afraid to tax at a time when higher taxation would have been submitted to most cheerfully by the country. There was also the absurd weakness of our Finance Ministers and our leading financial officials, which allowed our financial machinery to be so much weakened by the demands of the War Office for enlistment that it has been said in the House of

Commons by several Chancellors of the Exchequer that it is quite impossible to consider any form of new taxation because the machinery could not undertake it. There has also been great short-sightedness on the part of the business men of the country, who have failed to give the Government a lead in this important matter. Like the Government, they have taken short views, always hoping that the war might soon be over, and so have left the country with a problem that grows steadily more serious with each half-year as we drift stupidly along the line of least resistance.

Such war finance as I have outlined—drastic and impracticable as it seems—would have paid us. Taxation in war-time, when industry's problem is simplified by the Government's demand for its product, hurts much less than in peace, when industry has not only to turn out the stuff, but also find a buyer—often a more difficult and expensive problem. There is a general belief that by paying for war by loans we hand the business of paying for it on to posterity. In fact, we can no more make posterity pay us back our money than we can carry on war with goods that posterity will produce. Whatever posterity produces it will consume. Whatever it pays in interest and amortisation of our war debt, it will pay to itself. We cannot get a farthing out of posterity. All we can do, by leaving it a debt charge, is to affect the distribution of its wealth among its members. Each loan that we raise makes us taxpayers collectively poorer now, to the extent of the capital value of the charge on

our incomes that it involves. The less we thus charge our productive power, and the more we pay up in taxes as the war goes on, the readier we shall be to play a leading part in the great time of reconstruction.

V

A LEVY ON CAPITAL

January, 1918

The Objects of the Levy—Its Origin and History—How it would work in Practice—The Attitude of the Chancellor—The Effects of the Scheme in discouraging Thrift—Its Fallacies and Injustices—The Insuperable Obstacles to its Application—Its Influence on Production—One of the Tests of a Tax—Judged by this Test the Proposed Levy is doomed.

By some curious mental process the idea of a levy on capital has come into rapidly increasing prominence in the last few months, and seems to be gaining popularity in quarters where one would least expect it. On the other hand, it is naturally arousing intense opposition, both among those who would be most closely affected by its imposition, and also among those who view with grave concern the possible and probable economic effects of such a system of dealing with the national debt. I say "dealing with the national debt" because, as will be clear, as a system of raising money for the war the suggestion of the levy on capital has little or nothing to recommend it. But, as will also be made clear, the proposal has been put forward as a thing to be done immediately in order to increase the funds in the hands of the Chancellor of the Exchequer to be spent on war purposes.

A levy on capital is, of course, merely a variation of the tax on property, which has long existed in the United States, and had been resorted to before now by Governments, of which the German Government is a leading example, in order to provide funds for a special emergency. This it can very easily do as long as the levy is not too high. If, for example, you tax a man to the extent of 1½ per cent. to 2 per cent. of the value of his property, on which he may be earning an average of 5 to 6 per cent. in interest, then the levy on capital becomes merely a form of income tax, assessed not according to the income of the taxpayer but according to the alleged value of his property. It is thus, again, a variation of the system long adopted in this country of a special rate of income tax on what is called " unearned " income, *i.e.* income from invested property. But it is only when one begins to adopt the broadminded views lately fashionable of the possibilities of a levy on capital and to talk of taking, say, 20 per cent. of the value of a man's property from him in the course of a year, that it becomes evident that he cannot be expected to pay anything like this sum, in cash, unless either a market is somehow provided—which seems difficult if all property owners at once are to be mulcted of a larger amount than their incomes—or unless the Government is prepared to accept part at least of the levy in the shape of property handed over at a valuation.

Before, however, we come to deal in detail with the difficulties and drawbacks of the suggestion, it may be interesting to trace the history of the movement

in its favour, and to see some of the forms in which it has been put forward. It may be said that the ball was opened early last September when, in the *Daily News* of the 8th of that month, its able and always interesting editor dealt in one of his illuminating Saturday articles with the question of "How to Pay for the War." He began with the assumption that the capital of the individuals of the nation has increased during the war from 16,000 millions to 20,000 millions. A 10 per cent. levy on this, he proceeded, would realise 2000 millions. It would extinguish debt to that amount and reduce the interest on debt by 120 millions. The levy would be graduated—say, 5 per cent. on fortunes of £1000 to £20,000; 10 per cent. on £20,000 to £50,000; up to 30 per cent. on sums over £1,000,000; and the individual taxpayer was to pay the levy "in what form was convenient, in his stocks or his shares, his houses or his fields, in personalty or realty."

Just about the same time the *Round Table*, a quarterly magazine which is usually most illuminating on the subject of finance, chimed in with a more or less similar suggestion in an article on "Finance After the War." It remarked that the difficulty of applying a levy on capital is "probably not so great as appears at first sight." The total capital wealth of the community it estimated at about 24,000 millions sterling. To pay off a war debt of 3000 millions would therefore require a levy of one-eighth. "Evidently this could not be raised in money, nor would it be necessary. Holders of War Loans would pay their proportion in a simple way by surrendering

one-eighth of their scrip. Holders of other forms of property would be assessed for one-eighth of its value and be called on to acquire and to surrender to the State the same amount of War Loan scrip. To do this, they would be obliged to realise a part of their property or to mortgage it, " but," added the *Round Table* cheerfully, " there is no insuperable difficulty about that."

The first thing that strikes one when one examines these two schemes is the difference in their view concerning the amount of capital wealth available for taxation. Mr Gardiner made the comparatively modest estimate of 16,000 millions to 20,000 millions ; the *Round Table* plumps for 24,000 millions, and, incidentally, it may be remarked that some conservative estimates put it as low as 11,000 millions. Thus we have a possible range for the fancy of the scheme builder of from 11,000 to 24,000 millions in the property on which taxation is proposed to be levied. But it is when we come to the details of these schemes that the difficulties begin to glare. Mr Gardiner tells us that millionaires would pay up to 30 per cent. of their property, and that they would pay in what form was convenient, in houses, fields, etc., etc. But he does not explain by what principle the Government is to distribute among the holders of the debt, the repayment of whom is the object of the levy, the strange assortment of miscellaneous assets which it would thus collect from the property owners of the country.

In commenting on this scheme the *Economist* of September 15th took the case of a man with a

fortune of £100,000 invested before the war in a well-assorted list of securities, the whole of which he had, for patriotic reasons, converted during the war into War Loans. He would have no difficulty about paying his capital levy, for he would obviously surrender something between 10 and 20 per cent. of his holding. But, "in exchange for nearly two-thirds of the rest, he might find himself landed with houses and bits of land all over the country, a batch of unsaleable mining shares, a collection of blue china, a pearl necklace, a Chippendale sideboard, and a doubtful Titian." The *Round Table's* suggestion seems to be even more impracticable. According to it, holders of all other forms of property besides War Loans would be assessed for one-eighth of its value—it does not explain how the value is to be arrived at, nor how long it would take to do it—and would then be called on to acquire and to surrender to the State the same amount of War Loan scrip. To do this they would be obliged to realise a part of their property or to mortgage it, a process which would seem likely to produce a pretty state of affairs in the property market; and a very pleasant state of affairs indeed would arise for the holders of War Loan scrip, since there would be a large crowd of compulsory buyers in the market from whom the holders would apparently be able to extort any price that they liked for their stock.

The next stage in the proceedings was a deputation to the Chancellor of the Exchequer, concerning which more anon, of leaders of various groups of the Labour Party, to press upon Mr Bonar Law the

principle of what is called "the Conscription of Wealth," and the publication at or soon after that time, which was about the middle of November, of a pamphlet on the subject of the "Conscription of Riches," by the War Emergency Workers' National Committee, 1, Victoria Street, S.W. Among what this pamphlet describes as "the three practicable methods of conscripting wealth" No. 1 is as follows:—

> A Capital Tax, on the lines of the present Death Duties, which are graduated from nothing (on estates under £300, and legacies under £20) up to about 20 per cent. (on very large estates left as legacies to strangers).
>
> If a "Death Duty" at the existing rates were now levied simultaneously on every person in the kingdom possessing over £300 wealth (every person might be legally deemed to have died, and to be his own heir), it might yield to the Chancellor of the Exchequer about £900,000,000. It would be necessary to offer a discount for payment in cash; and in order to avoid simultaneous forced sales, to accept, in lieu of cash, securities at a valuation; and to take mortgages on land.

Here it will be seen that the Emergency Workers had improved on the *Round Table*, and agreed with Mr Gardiner, by providing that the Government should take securities at a valuation and mortgages on land in lieu of cash in order to avoid simultaneous forced sales. But they do not seem to have perceived that, in so far as the Government took securities or accepted mortgages on land, it would not be getting money to pay for the war, which was the object of the proposed Conscription of Wealth, but would only be obtaining property from which the

Government would in due course later on receive an income, probably averaging about one-twentieth of its value.

Perhaps, however, it would be more correct to say that those who put the scheme forward did not ignore this drawback to it, but rather liked it, for reasons quite irrelevant to the objects that they were apparently pursuing. A good deal of prominence was given about the same time to the question of a levy on capital in the *New Statesman* well known to be the organ of Mr Sidney Webb and other members of the Fabian Society. These distinguished and very intellectual Socialists would, of course, be quite pleased if, in an apparent endeavour to pay for the war, they actually succeeded in securing, by the Government's acquisition of blocks of securities from property owners, that official control of industry and production which is the object of State Socialists.

It will be noted, however, in this scheme that no mention is made of any forms of property to be accepted by the Government in lieu of cash except securities and mortgages on land. Items such as furniture, books, pictures and jewellery are ignored, and in one of the articles in the *New Statesman*, discussing the question of a capital levy, it was distinctly suggested that these commodities should be left out of the scheme so as to save the trouble involved by valuation. Unfortunately, if we leave out these forms of property the natural result is to stimulate the tendency, lately shown by an unfortunately large number of patriotic taxpayers, of putting money into pearl necklaces and other such

gewgaws in order to avoid income tax. If by buying fur coats, old masters and diamond tiaras it will be possible in future to avoid paying, not only income tax, but also a capital levy, it is to be feared that appeals to people to save their money and invest it in War Bonds are likely to be seriously interfered with.

Unfortunately, the *Statesman* was able to announce that the appeal for this system of taxation had been received with a good deal of sympathy by the Chancellor of the Exchequer, and the next stage in the history of the agitation was the publication on Boxing Day in several of the daily papers of what appeared to be an official summary, issued through the Central News, of what the Chancellor had said to the deputation of Labour Leaders introduced by Mr Sidney Webb, which waited on him, as already described, in the middle of November. Having pointed out that he had never seen any proposal which seemed to him to be practicable for getting money during the war by conscripting wealth, Mr Bonar Law added that, though " perhaps he had not thought enough about it to justify him in saying so," his own feeling was that it would be better, both for the wealthy classes and the country, to have this levy on capital, and reduce the burden of the national debt when the war was over. It need not be said that this statement by the Chancellor has been very far from helpful to the efforts of those who are trying to induce unthrifty citizens to save their money and put it into National War Bonds for the finance of the war.

"Why," people argue, "should we go out of our way to save and take these securities if, when the war is over, a large slice of our savings is to be taken away from us by means of this levy on capital? If we had been doubting between the enjoyment of such comforts and luxuries as are possible in war-time and the austere duty of thrift, we shall naturally now choose the pleasanter path, spend our money on ourselves and on those who depend on us, instead of saving it up to be taken away again when the war is over, while those who have spent their money as they liked will be let off scot free." Certainly, it is much to be regretted that the Chancellor of the Exchequer should have let such a statement go forth, especially as he himself admits that perhaps he has not thought enough about it to justify him in saying so. If the Chancellor of the Exchequer has not time to think about what he is going to say to a Labour deputation which approaches him on an extremely important revolution in our fiscal system, it is surely high time that we should get one who has sufficient leisure to enable him to give his mind to problems of this sort when they are put before him.

In the course of this review of the forms in which suggestions for a levy on capital have been put forward, some of the difficulties and injustices inherent in it have already been pointed out. Its advocates seem as a rule to base the demand for it upon an assumption which involves a complete fallacy. This is that, since the conscription of life has been applied during the war, it is necessary that conscription of wealth should also be brought to

bear in order to make the war sacrifice of all classes equal. For instance, the Emergency Workers' pamphlet, quoted above, states that, "in view of the fact that the Government has not shrunk from Compulsory Conscription of Men," the Committee demands that "for all the future money required to carry on the war, the Government ought, in common fairness, to accompany the Conscription of Men by the Conscription of Wealth."

This contention seems to imply that the conscription of men and the conscription of wealth apply to two different classes; in other words, that the owners of wealth have been able to avoid the conscription of men. This, of course, is absolutely untrue. The wealthiest and the poorest have to serve the country in the front line alike, if they are fit. The proportion of those who are fit is probably higher among the wealthy classes, and, consequently, the conscription of men applies to them more severely. Again, the officers are largely drawn from the comparatively wealthy classes, and it is pretty certain that the proportion of casualties among officers has been higher during the war than among the rank and file. Thus, as far as the conscription of men is concerned, the sacrifice imposed upon all classes in the community is alike, or, if anything, presses rather more heavily upon those who own wealth. Conscription of wealth as well as conscription of life thus involves a double sacrifice to the owners of property.

This double sacrifice, in fact, the owners of property have, as is quite right, borne throughout the

war by the much more rapid increase in direct taxation than in indirect. It is right that the owners of property should bear the heavier monetary burden of the war because they, having more to lose and therefore more to gain by a successful end of the war, should certainly pay a larger proportion of its cost. It was also inevitable that they should do so because, when money is wanted for the war or any other purpose, it can only be taken in large amounts from those who have a surplus over what is needed to provide them with the necessaries and decencies of life. But the argument which puts forward a capital levy on the ground that the rich have been escaping war sacrifice is fallacious in itself, and is a wicked misrepresentation likely to embitter still further the bad feeling between classes.

Nevertheless, Mr Bonar Law thinks that, since the cost of the war must inevitably fall chiefly upon the owners of property, and since it therefore becomes a question of expediency with them whether they should pay at once in the form of a capital levy or over a long series of years in increased taxation, he is inclined to think that the former method is one which would be most convenient to them and best for the country. This contention cannot be set aside lightly, and there can be no doubt that if, by making a dead lift, the wealthy classes of the country could throw off their shoulders a large part of the burden of the war debt, such a scheme is well worth considering as long as it does not carry with it serious drawbacks.

It seems to me, however, that the drawbacks are

very considerable. In the first place, I have not seen any really practicable scheme of redeeming debt by means of a levy on capital. In so far as the levy is paid in the form of surrendered War Loans, it is simple enough. In so far as it is paid in other securities or mortgages on land or other forms of property, it is difficult to see how the assets acquired by the State through the levy could be distributed among the debt holders whom it is proposed to pay off. Would they be forced to take securities, mortgages on land, furniture, etc., as the Government chose to distribute them, or would the Government have to nurse an enormous holding of various forms of property and gradually realise them and so pay off debt ?

Again, a great injustice would surely be involved by laying the whole burden of this oppressive levy upon owners of accumulated property, so penalising those who save capital for the community and letting off those who squander their incomes. A characteristic argument on this point was provided by the *New Statesman* in a recent issue. It argued that, because ordinary income tax would still be exacted, the contrast between the successful barrister with an income of £20,000 a year and no savings, who would consequently escape the capital levy, and the poor clergyman who had saved £1000 and would consequently be liable to it, fell to the ground. In other words, because both lawyer and parson paid income tax, it was fair that the former should escape the capital levy while the latter should have to pay it !

But needs must when the devil drives, and in a

crisis of this kind it is not always possible to look too closely into questions of equity in raising money. It is necessary, however, to look very closely into the probable economic effects of any suggested form of taxation, and, if we find that it is likely to diminish the future wealth production of the nation, to reject it, however attractive it may seem to be at first sight. A levy on capital which would certainly check the incentive to save, by the fear that, if such a thing were once successfully put through, it might very likely be repeated, would dry up the springs of that supply of capital which is absolutely essential to the increase of the nation's productive power. Moreover, business men who suddenly found themselves shorn of 10 to 20 per cent. of their available capital would find their ability to enter into fresh enterprise seriously diminished just at the very time when it is essential that all the organisers of production and commerce in this country should be most actively engaged in every possible form of enterprise, in order to make good the ravages of war.

VI

OUR BANKING MACHINERY

February, 1918

The Recent Amalgamations—Will the Provinces suffer ?—Consolidation not a New Movement—The Figures of the Past Three Decades—Reduction of Competition not yet a Danger—The Alleged Neglect of Local Interests—Shall we ultimately have One Huge Banking Monopoly ?—The Suggested Repeal of the Bank Act—Sir E. Holden's Proposal.

BANKING problems have lately loomed large in the financial landscape. It will be remembered that about a year and a half ago a Committee was appointed to consider the creation of a new institution specially adapted for financing overseas trade and for the encouragement of industrial and other ventures through their years of infancy, and that the charter which was finally granted to the British Trade Corporation, as this institution was ultimately called, roused a great deal of opposition both on the part of banks and of traders who thought that a Government institution with a monopoly character was going to cut into their business with the help of a Government subsidy. In fact, there was no subsidy at all in question, and the fears of the

trading world of competition on the part of the new chartered institution only arose owing to its unfortunate name, which was given to it in order to allay the apprehensions of the banks which had been provoked by the title originally designed for it, namely, the British Trade Bank. There seems no reason why this Company should not do good work for British trade without treading on the toes of anybody. Although naturally its activities cannot be developed on any substantial scale until the war is over, its Chairman assured the shareholders at the end of January that its preliminary spadework was being carefully attended to.

After this small storm in a teacup had died down those interested in our banking efficiency were again excited by the rapid progress made by the process of amalgamation among our great banks, which began to show acute activity again in the last months of 1917. The suddenly announced amalgamation of the London and South-Western and London and Provincial Banks led to a whole host of rumours as to other amalgamations which were to follow; and though most of these proved to be untrue a fresh sensation was aroused when the union was announced of the National Provincial Bank of England and the Union of London and Smith's Bank. All the old arguments were heard again on the subject of the objections, from the point of view of industry in the provinces, to the formation of great banking institutions, with enormous figures on both sides of the balance-sheet, working from London, often, it was alleged, with

no consideration for the needs of the provincial users of credit. These latest amalgamations, which have united banks which already had head offices in London, gave less cause than usual for these provincial apprehensions, which had far more solid reason behind them when purely provincial banks were amalgamated with institutions whose head office was in London. Nevertheless, the argument was heard that the great size and scale on which these amalgamated banks were bound to work would necessarily make them more monopolistic and bureaucratic in their outlook, and less elastic and adaptable in their dealings with their local customers.

It seems to me that there is so far very little solid ground for any apprehension on the part of the business community that the recent development of banking evolution will tend to any damage to their interests. The banks have grown in size with the growth of industry. As industry has tended more and more to be worked by big battalions, it became necessary to have banking institutions with sufficiently large resources at their command to meet the great requirements of the huge industrial organisations that they had to serve. Nevertheless, the tendency towards fewer banks and bigger figures has grown with extraordinary celerity, as the following table shows :—

MOVEMENT OF ENGLISH JOINT-STOCK BANK DEPOSITS, ETC., SINCE 1886.

December 31st.	No. of Banks.	Number of Branches.	Capital Paid up.	Deposit and Current Accounts.	Total Liabilities.
1886	109	1,547	£38,468,000	£299,195,000	£376,808,000
1891	106	2,245	43,406,000	391,842,000	486,632,000
1896	94	3,051	45,203,000	495,233,000	599,518,000
1901	74	3,935	46,631,000	584,841,000	698,150,000
1906	55	4,840	48,122,000	647,889,000	782,353,000
1911	44	5,417	47,265,000	748,641,000	885,069,000
1916	35	5,993	48,237,000	1,154,877,000	1,316,220,000

This table is taken from the annual banking numbers of the *Economist*. It will be noticed that in 1886 there were in England 109 joint-stock banks with 1547 offices, whose accounts were tabulated in the *Economist's* annual review. Their total paid-up capital was 38½ millions, their deposit and current accounts were just under 300 millions, and their total liabilities were 377 millions. In the course of thirty years the 109 banks had shrunk by the process of amalgamation and absorption to thirty-five, that is to say, they had been divided by three; the number of their offices, however, had been multiplied by nearly four, while their deposit accounts had grown from 300 millions to 1155, and their total liabilities from 377 to 1316 millions. By the amalgamations announced at the end of 1917, and that of the County and Westminster with Parr's announced on February 1st, the number of joint stock banks will be reduced to 32. The picture would be still more striking if the figures of the

private banks were included, since their number has been reduced, since 1891, from 37 to 6. These figures are eloquent of the manner in which the number of individual banks has been reduced, while the extent of the banking accommodation given to the community has enormously grown, so that the power wielded by each individual bank has increased by the force of both these processes.

The consequent reduction in competition which is causing some concern among the trading community has not, as it seems to me, gone far enough yet to be a serious danger. The idea that the big banks with offices in London give scant consideration to the needs of their local customers seems to be so contrary to the interests of the banks that they would be extraordinarily bad men of business if those who were responsible for their management allowed it to be the fact. It is probably nearer the truth that banking competition in the provinces is still so keen that the London management is very careful not to allow anything like bureaucratic stiffness to get into the methods by which their business is managed. By the appointment of local committees they are careful to do all they can to see that the local interests get all the credit that is good for them. That local interests get as much credit as they want is probably very seldom the case, because it is a natural instinct on the part of an eager business man to want rather more credit than he ought to have, from a banking point of view. Business interests, as long as they exist in private hands, will always want rather more credit than

there is available, and it will always be the duty of the banker to ensure that the country's industry is kept on a sound basis by checking the tendency of the eager business man to undertake rather more than is good for him. From the sentimental point of view it is certainly a pity to have seen many of the picturesque old private banks extinguished, the partners in which were in close personal touch with their customers, and entered into the lives of the local communities in a manner which their modern counterpart is perhaps unable to do. Nevertheless, it is difficult to get away from the fact that if these institutions had been as efficient and as well managed as their admirers depict them to have been they would hardly have been driven out of existence by the stress of modern developments and competition. Whatever we may think of modern competition, in certain of its aspects, we may at least be sure of this —that it does not destroy an institution which is really wanted by the business community. And if the complaint of local interests is true, that they are swamped by the cosmopolitan aspirations of the great London offices, they always have it in their power to create an institution of the kind that they want, and by giving it their business to ensure for it a prosperous career. As long as no such tendency is visible in the banking world we may be pretty sure that the views expressed concerning the neglect of local interests by the enormous banks which have grown up with London centres in the last thirty years is to a great extent a myth. It has now been announced, however, that the whole problem

involved by the amalgamation process is to be sifted by a committee to be appointed for this purpose.

Another apprehension has arisen in the minds of those who view with critical vigilance the present tendencies of business and the present development of economic opinion among a great section of the community. If, it is urged, the banks continue to swallow one another up by the process of amalgamation, how will this tendency end except in the creation of one huge bank working a gigantic money monopoly which the Socialistic tendencies of the present day will, with some reason, insist ought to be taken over by the State for the profit of the taxpayer? This view is frankly put forward by those advocates of a Socialistic organisation of society, who say that the modern tendency of industry towards combinations, rings and trusts is rapidly bringing the Socialistic millennium within their reach without any effort on the part of Socialistic preachers. They consider that the trust movement is doing the work of Socialism, much faster than Socialism could do it for itself; that, in short, as has been argued above in regard to banking, the tendency towards centralisation and the elimination of competition can only end in the assumption by the State of the functions of industry and finance. If this should be so, the future is dark for those of us who believe that individual effort is the soul of industrial and financial progress, and that industry carried on by Government Departments, however efficient and economical it might be, would be such a deadly dull and unenterprising business that all the adaptability and

tendency to variation in accordance with the needs of the moment, which are so strongly shown by individual enterprise, would be lost, to the great detriment of the material progress of mankind.

As things are at present, there is little need to fear that Socialistic organisation of industry could stand up against competent individual effort. Anybody who has ever had any business dealings with a Government Department will inevitably shudder when he tries to imagine how many forms would have to be filled up, how many divisions of the Department the inevitable mass of papers would have to go through, and how much delay and tedium would be involved before the simplest business proposition could be carried out. But, of course, it is argued by Socialists that Government Departments are only slow and tied up with red tape because they have so long been encouraged to do as little as possible, and that as soon as they are really urged to do things instead of pursuing a policy of masterly inactivity, there is no reason why they should not develop a promptitude and elasticity quite as great as that hitherto shown by the business community. That such a development as this might take place in the course of generations nobody can deny; at present it must be admitted that with the great majority of men the money-making incentive is required to get the best out of them. If the process of education produces so great a change in the human spirit that men will work as well for the small salary of the Civil Service, with a K.C.B. thrown in, as they will now in order to gain the prizes of industry

and finance, then perhaps, from the purely economic point of view, the Socialisation of banking may be justified. But we are a long way yet from any such achievement, and if it is the case that the rapid centralisation of banking power in comparatively few hands carries with it the danger of an attempt to nationalise a business which requires, above all, extreme adaptability and sensitiveness to the needs of the moment as they arise, this is certainly a danger which has to be carefully considered by those who are responsible for the development of these amalgamation processes.

And now another great stone has been thrown into the middle of the banking pond, causing an ever-widening circle of ripples and provoking the beginning of a discussion which is likely to be with us for some time to come. Sir Edward Holden, at the meeting of the London City and Midland Bank shareholders on January 29th, made an urgent demand for the immediate repeal of the Bank Act of 1844. This Act was passed, as all men know, in order to restrict the creation of credit in the United Kingdom. In the early part of the last century the most important part of a bank's business consisted of the issue of notes, and banking had been carried on in a manner which the country considered unsatisfactory because banks had not paid sufficient attention to the proportion of cash that they ought to hold in their tills to meet notes if they were presented. Parliament in its wisdom consequently ordained that the amount of notes which the banks should be allowed to issue, except against actual

metal in their vaults, should be fixed at the amount of their issue at that time. Above the limit so laid down any notes issued by the banks were to be backed by metal. In the case of the Bank of England the limit then established was £14,000,000, and it was enacted that if any note-issuing bank gave up its right to a note issue the Bank of England should be empowered to increase its power to issue notes against securities to the extent of two-thirds of the power enjoyed by the bank which was giving up its privilege. By this process the Bank of England's right to issue notes against securities, what is usually called its fiduciary issue, has risen to £18,450,000; above that limit every note issued by it has to be backed by bullion, and is actually backed by gold, though under the Act one-fifth might be in silver. It was thus anticipated by the framers of the Act that in future any credit required by industry could only be granted by an increase in the gold held by the issuing banks. If the Act had fulfilled the anticipations of the Parliament which passed it, if English trade had grown to anything like the extent which it has done since, it could only have done so by the amassing of a mountain of gold, which would have lain in the vaults of the Bank of England.

Fortunately, however, the banking community had at its disposal a weapon of which it was already making considerable use, namely, the system of issuing credit by means of banking deposits operated on by cheques. Eight years before Peel's Act was passed two Joint Stock Banks had been founded in London, although the Bank of England note-issuing

monopoly still made it impossible for any Joint Stock Bank to issue notes in the London district. It is thus evident that deposit banking was already well founded as a profitable business when Peel, and Parliament behind him, thought that they could sufficiently regulate the country's banking system so long as they controlled the issue of notes by the Bank of England and other note-issuing banks. It is perhaps fortunate that Parliament made this mistake, and so enabled our banking machinery to develop by means of deposit banking, and so to ignore the hard-and-fast regulations laid upon it by Peel's Act. This, at least, is what has happened; only in times of acute crisis have the strict regulations of Peel's Act caused any inconvenience, and when that inconvenience arose the Act has been suspended by the granting of a letter of indemnity from the Treasury to the Governor of the Bank.

Under Peel's Act the present rather anomalous form of the Bank of England's Weekly Return was also laid down. It shows, as all men know, two separate statements; one of the Issue Department and the other of the Banking Department. The Issue Department's statement shows the notes issued as a liability, and on the assets side Government debt and other securities (which are, in fact, also Government securities), amounting to £18,450,000 as allowed by the Act, and a balance of gold. The Banking Department's statement shows capital, "Rest" or reserve fund, and deposits, public and other, among the liabilities, and on the other side

of the account Government and other securities, all the notes issued by the Issue Department which are not in circulation, and a small amount of gold and silver which the Banking Department holds as till money.

Sir Edward Holden's proposal is that the Act should be repealed practically in accordance with the system which has been adopted by the German Reichsbank. The principles which he enumerates, as those on which other national banks of issue work, are as follows :—

1. One bank of issue, and not divided into departments.

2. Notes are created and issued on the security of bills of exchange and on the cash balance, so that a relation is established between the notes issued and the discounts.

3. The notes issued are controlled by a fixed ratio of gold to notes or of the cash balance to notes.

4. This fixed ratio may be lowered on payment of a tax.

5. The notes should not exceed three times the gold or cash balance.

By this revolution Sir Edward would abolish all legal restriction on the issue of notes by the Bank of England. It would hold a certain amount of gold or a certain amount of cash balance against its notes, but in the " cash balance " Sir Edward apparently would include 11 millions odd of Government debt, or of Treasury notes. As long as its notes were only three times the amount of the gold or of the " cash balance," and were backed as to the other two-thirds

by bills of exchange, the situation would be regarded as normal, but if, owing to abnormal circumstances, the Bank desired to increase the amount of notes issued against bills of exchange only and to reduce the ratio of its gold or its cash balance to its notes, it would, at any time, be enabled to do so by the payment of a tax, without going through the humiliating necessity for an appeal to the Treasury to allow it to exceed the legal limit.

At the same time, by the abolition of Peel's Act the cumbrous methods of stating the Bank's position, as published week by week in the Bank Return, would be abolished. The two accounts would be put together, with the result that the Bank's position would be apparently stronger than it appears to be under the present system, which makes the Banking Department's Return weak at the expense of the great strength that it gives to the appearance of the Issue Department. This will be shown from the following statement given by Sir Edward Holden of the Return as issued on January 16th, and as amended according to his ideas :—

BANK STATEMENT, JANUARY 16, 1918.

ISSUE DEPARTMENT.

Notes Issued	£76,076,000	Gold	£57,626,000
		Government Debt	11,015,000
		Other Securities	7,435,000
	£76,076,000		£76,076,000

Ratio of Gold to Notes Issued = 75·7 per cent.

BANKING DEPARTMENT.

Capital	£14,553,000	Government Securities	£56,768,000
Rest	3,363,000	Other Securities	92,278,000
Deposits—		Notes £30,750,000	
Public £41,416,000		Gold and Silver 1,143,000	
Other 121,589,000			
	163,005,000		31,893,000
Other Liabilities	18,000		
	£180,939,000		£180,939,000

Ratio of Cash Balance to Liabilities = 19·6 per cent.

RECONSTRUCTED BALANCE-SHEET OF THE BANK, JANUARY 16, 1918.

Capital	£14,553,000	Gold	£58,768,000	
Rest	3,363,000	Currency Notes	11,015,000	
Notes Issued (circulation)	45,325,000			£69,783,000
Deposits	163,005,000	Government Securities	56,768,000	
Other Liabilities	18,000	Other Securities	7,435,000	
				64,203,000
		Other Securities		92,278,000
	£226,264,000			£226,264,00

Ratio of Gold to Notes = 129·7 per cent.
,, ,, Cash Balance to Liabilities = 33·5 ,,

It need not be said that these proposals have aroused the liveliest interest. At the Bank Meetings held since then several chairmen have been asked by their shareholders to express their views on Sir Edward's proposed revolution. Sir Felix Schuster pronounced cautiously in favour of the revision of the Bank Act, and said that he had advocated it seventeen years ago. Lord Inchcape, at the National Provincial Meeting, thought that the matter required careful consideration. Most of us will agree with this view. There is certainly much to be said for a reform of the Weekly Statement of the Bank of England, giving, it may be added, a good deal more detail than Sir Edward's revised balance-sheet affords. But concerning his proposal to reconstrucs our system of note issue on a foreign model, there it certain to be much difference of opinion. In the first place, owing to the development of our system of banking by deposit and cheque rather than by issue and circulation of notes, the note issue is not nearly so important a business in normal times in this country as it is in Germany and France.

Moreover, the check imposed upon our banking community by the need for an appeal to the Treasury before it can extend its note issue beyond a certain point often acts with a salutary effect, and the view has even been expressed that if that check were taken away from our system it might be difficult, if not impossible, to maintain the gold standard which has been of such enormous value in building up the prestige of London as a financial centre. I do not think there is much weight in this argument, since, under Sir Edward's plan, the note issue could only be increased against discounts, and the Bank, by the charge that it made for discounts, would still be able to control the situation. From the practical point of view of the present moment, a strong objection to the scheme is that it would open the door to fresh inflation by unrestricted credit-making just when the dangers of this process are beginning to dawn even on the minds of our rulers.

VII

THE COMPANIES ACTS

March, 1918.

Another Government Committee—The Fallacy of imitating Germany—Prussianising British Commerce—The Inquiry into the Companies Acts—Will Labour Influence dominate the Report ?—Increased Production the Great Need—Will it be met by tightening up the Companies Acts ?—The Dangers of too much Strictness—Some Reforms necessary —Publicity, Education, Higher Ideals the only Lasting Solution—The Importance of Foreign Investments—Industry cannot take all Risks and no Profits.

EVERY week—almost every day—brings with it the announcement of some new committee considering some question that may, or may not, arise now or when the war is over. Especially in the realm of finance has the Government's output of committees been notably prolific of late. We have had a Committee on Currency, a Committee on Banking Amalgamations, and a Committee appointed, humorously enough, by the Ministry of Reconstruction to consider what measures, if any, should be taken to protect the public interest in connection with the policy of industrial combinations—a policy which the Board of Trade has been sedulously fostering. Now comes a Committee to inquire " what amendments are expedient in the Companies Acts, 1908–1917,

principally having regard to the circumstances arising out of the war, and to the developments likely to arise on its conclusion, and to report to the Board of Trade and to the Ministry of Reconstruction." It is composed of the Right Hon. Lord Wrenbury (chairman), Mr A. S. Comyns Carr, Sir F. Crisp, Mr G. W. Currie, M.P., Mr F. Gaspard Farrer, Mr Frank Gore-Browne, K.C., Mr James Martin, the Hon. Algernon H. Mills, Mr R. D. Muir, Mr C. T. Needham, M.P., Mr H. A. Payne, Sir Owen Philipps, M.P., Sir William Plender, Mr O. C. Quekett, and Mr A. W. Tait. The secretary is Mr W. W. Coombs, 55, Whitehall, S.W. 1. There are some good names on the Committee. Mr. Gaspard Farrer represents a great issuing house; Sir Frank Crisp, company lawyers; Sir William Plender, the accountants; Mr O. C. Quekett, the Stock Exchange; and Sir Owen Philipps, the shipping interest. Nevertheless, one cannot help shuddering when one considers the dangers that threaten British finance and industry from ill-considered measures which might possibly be recommended by a Committee influenced by the atmosphere of the present outlook on financial and commercial affairs.

One of the interesting features of the present war atmosphere is the fact that, now when we are fighting as hard as we can to defeat all that is meant by Prussianism a great many of our rulers and public men are doing their best to impose Prussianising methods upon this unfortunate country, merely because it is generally assumed that Prussian methods have been shown, during the course of the

war, to carry with them a certain amount of efficiency. It is certainly true that Prussian methods do very well as applied to the Prussians and submitted to by other races of Germans. On the other hand, it is at least open to argument that the British method of freedom, individual initiative, elasticity and adaptability have produced results, during the present war, which have so far been paralleled by no other country engaged in the contest. Working on interior lines with the assistance of docile and entirely submissive allies, Germany has certainly done wonderful things in the war, but it by no means follows that the verdict of posterity will not give the palm of achievement to England, who has not only carried out everything that she promised to do before the war, but has incidentally and in the course of it created and equipped an Army on a Continental scale, and otherwise done very much more for the assistance of her Allies than was contemplated before the war began.

It is untrue to say that we were unprepared for the war. We were more than prepared to do all that we promised to do. What we were unprepared for was finding ourselves required to turn ourselves into, not only the greatest naval Power in the world, but one of the greatest military Powers also. This demand was sprung upon us, and we have met it with extraordinary success. The whole idea that Germany's achievement has been such as to warrant any attempt on our part to model our institutions on her pattern seems to me to fall to pieces as soon as one looks calmly at the actual results produced by

the different systems. Moreover, even if we were to admit that Germany's achievement in the war has been immeasurably greater than ours, it still would not follow that we could improve matters here by following the German system. It ought not to be necessary to observe that a system which is good for one nation or individual is not necessarily good for another. In the simple matter of diet, for instance, a most scientifically planned diet given to a child who does not happen to like it will not do that child any good. These things ought to be obvious, but unfortunately in these times, which call for eminently practical thought and effort, there is a curious doctrinaire spirit abroad, and the theorist is continually encouraged to imagine how much better things would be if everything were quite different, whereas what we want is the application of practical common sense to practical facts as they are.

In the realm of finance the freedom and individual initiative and elasticity of our English system have long been the envy of the world. Our banking system, as was shown on an earlier page, has always worked with much less restriction on the part of legislative and official interference than any other, and, with the help of this freedom from official control, English bankers and finance houses had made London the financial centre of the world before the war. The attempt of Parliament to control banking by Peel's Act of 1844 was quietly set aside by the banking machinery through the development of the use of cheques, which made the regulations imposed on the

note issue a matter of quite minor importance, except in times of severe crisis, when these regulations could always be set aside by an appeal to the Chancellor of the Exchequer. There was no Government interference in the matter of new issues of securities on the London Stock Exchange or of the quotations granted to new securities by the Committee of the Stock Exchange. Now the Companies Acts are to be revised in view of what may be necessary after the war, and there is only too much reason to fear that mistakes may occur through the imposition of drastic restrictions, which look so easy to work on paper, but are more than likely to have the actual effect of doing much more harm than good.

"Circumstances arising out of the war and developments likely to arise on its conclusion" give this Committee a roving commission to consider all kinds of things, which may or may not happen, in the light of wisdom which may be put before it by interested witnesses, and, worse still, in the light of semi-official pressure to produce a report which will go down well with the House of Commons. Our politicians are at present in a state of extreme servility before the enterprising gentlemen who are now at the head of what is called the Labour Party. Every one will sympathise with the aspirations of this party in so far as they aim at bettering the lot of those who do the hard and uninteresting work of the world, and giving them a larger share of the productions that they help to turn out; but that is not the same thing as giving obsequious attention to the views which their representatives may have

concerning the management of financial affairs, on the subject of which their knowledge is necessarily limited and their outlook is likely to be, to a certain extent, prejudiced. A recent manifesto put forward by the leaders of the new Labour Party includes in its programme the acquisition by the nation of the means of production—in other words, the expropriation of private capitalists. The Labour people very probably think that by this simple method they will be able to save the labourer the cost of providing capital and the interest which is paid for its use; and people who are actuated by this fallacy, which implies that the rate paid to capital is thinly disguised robbery, inevitably have warped views concerning the machinery of finance and the earnings of financiers. These views, expressed in practical legislation, might have the most serious effects not only upon England's financial supremacy but also on the industrial activity which that financial supremacy does so much to maintain and foster.

What, after the war, will be the most important need, from the material point of view, for the inhabitants of this country? However the war may end, and whatever may happen between now and the end of it, there can be only one answer to this question, and that answer is greatly increased production. The war has already diminished our capital resources to the extent of the whole amount that we have raised by borrowing abroad, that is to say, by pledging the production of our existing capital, and by selling to foreign countries the foreign securities in which our capitalists had invested

during the previous century. No one knows the extent to which our capital resources have been impaired by these two processes, but it may be guessed at as somewhere in the neighbourhood of 1500 millions ; that is to say, about 10 per cent. of a liberal estimate of the total accumulated property of the country at the beginning of the war. To this direct diminution in our capital resources we have to add the impossibility, which has existed during the war, of maintaining our factories and industrial equipment in first-class working order by expenditure on account of depreciation of plant. On the other side of the balance-sheet we can put a large amount of new machinery introduced, which may or may not be useful for industrial purposes after the war ; greatly improved methods of organisation, the effect of which may or may not be spoilt when the war is over by uncomfortable relations between Capital and Labour ; and our loans to Allies and Dominions, some of which may have to be written off, and most of which will return us no interest for some time to come, or will at first pay us interest if we lend our debtors the money to pay it with. What the country will need, above all, on the material side, is an abundant revenue, which can only be produced by vigorous and steady effort in industry, which, again, can only be forthcoming if the machinery of credit and finance is given the fullest possible freedom to provide every one who wants to engage in industry and increase the output of the country with the financial facilities, without which nothing can be done.

Is it, then, wise at such a time to impose restrictions by a drastic tightening up of the Companies Act, upon those who wish by financial activity, to further the efforts of industries and producers? On the contrary, it would seem to be a time to give the greatest possible freedom to the financial machine so that there shall be the least possible delay and difficulty in providing enterprise with the resources that it needs. We can only make good the ravages of war by activity in production and strict economy in consumption. What we want to do is to stimulate the people of this country to work as hard as they can, to produce as much as possible, to consume as little as possible on unnecessary enjoyment and luxury, and, so, by procuring a big balance of production over consumption, to have the largest possible volume of available goods for sale to the rest of the world, in order to rebuild our position as a creditor country, which the war's demands upon us have to some extent impaired.

It is a commonplace that if it had not been for the great mass of foreign securities, which this country held at the beginning of the war, we could not nearly so easily have financed the enormous amount of food and munitions which we have had to provide for our population, for our armies, and for the population and armies of our Allies. If, instead of holding a mass of easily marketable securities, we had had to rely, in order to pay for our purchases of foreign goods, on the productions of our own mines and factories, and on our power to borrow abroad, then we should have had to restrict

very greatly the number of men we have put into the firing-line so as to keep them at home for productive work, or, by the enormous amount of our borrowings, we should have cheapened the value of British credit abroad to a much greater extent than has been the case. Our position as a great creditor country was an enormously valuable asset, not only during the war but also before it, both from a financial and industrial point of view. It gave us control of the foreign exchanges by enabling us, at any time, to turn the balance of trade in our favour by ceasing for a time to lend money abroad, and calling upon foreign countries to pay us the interest due from them. The financial connections which it implied were of the greatest possible assistance to us in enhancing British prestige, and so helping our industry and commerce to push the wares that they produced and handled.

Reform of the Companies Acts has often before the war been a more or less burning question. Whenever the public thought that it had been swindled by the company promoting machinery, it used to write letters to the newspapers and point out that it was a scandal that the sharks of the City should be allowed to prey upon the ignorant public, and that something ought to be done by Parliament to insure that investments offered to the public should somehow or other be made absolutely watertight and safe, while by some unexplained method the public would still be somehow able to derive large benefits from fortunate speculations in enterprises which turned out right. Every one must

admit there have been some black pages in the history of British company promoting, and that many swindles have been perpetrated by which the public has lost its money and dishonest and third-rate promoters have retired with the spoil. The question is, however, what is the remedy for this admitted and glaring evil? Is it to be found by making the Companies Laws so strict that no respectable citizen would venture to become a director owing to the fear of penal servitude if the company on whose board he sat did not happen to pay a dividend, and that no prospectus could be issued except in the case of a concern which had already stood so severe a test that its earning capacity was placed beyond doubt? It would certainly be possible by legislative enactment to make any security that was offered as safe as Consols, and less subject to fluctuation in value. But when this had been done the effect would be very much like the effect upon rabbits of the recent fixing of their price. No more securities would be offered.

It is certainly extremely important for the future financial and industrial development of this country that the machinery of finance and company promotion should be made as clean as possible. What we want to do is to make everybody see that a great increase in output is required, that this great increase in output can only be brought about if there is a great increase in the available amount of capital, that capital can only be brought into being by being saved, and that it is therefore everybody's business, both for his own sake and that of the country, to

earn as much as he can and save as much as he can so that the country's capital fund can be increased ; so that industry, which will have many difficult problems to face when the war is over, shall be as far as possible relieved from any difficulty of finding all the capital that it needs. To produce these results it is highly necessary to increase the confidence of the public in the machinery of the Stock Exchange, in company promotion and all financial issues. Any one who sincerely believes that these results can be produced by tightening up the Companies Acts is not only entitled but bound to press as hard as he can for the securing of this object. But is this the right way to do it ? There is much to be said at first sight for making more strict the regulations under which prospectuses have to be issued under the Companies Acts, demanding a franker statement of the profits in the past, a fuller statement concerning the prices paid to vendors, and the prices paid by vendors to sub-vendors, and so forth. Any one who sits down with a pre-war industrial prospectus in his hand can find many openings for the hand of the reformer. The accounts published by public companies might also be made fuller and more informing with advantage. But even if these obviously beneficial reforms were carried out, there would always be danger of their evasion. They might tend to the placing of securities by hole-and-corner methods without the issue of prospectuses at all, and to all the endless devices for dodging the law which are so readily provided as soon as any attempt is made by legislation to

go too far ahead of public education and public feeling.

This is the real solution of this problem—publicity, the education of the public, and a higher ideal among financiers. As long as the public likes to speculate and is greedy and ignorant enough to be taken in by the wiles of the fraudulent promoter, attempts by legislation to check this gentleman's enterprise will be defeated by his ingenuity and the public's eagerness to be gulled. The ignorance of the public on the subject of its investments is abysmal, as anybody knows who is brought into practical touch with it. Just as the cure for the production of rotten and fraudulent patent medicines thrust down the public's throat by assiduous advertising is the education of the public concerning the things of its stomach, so the real cure for financial swindles is the education of the public concerning money matters, and its recognition of the fact that it is impossible to make a fortune in the City without running risks which involve the possible, not to say probable, loss of all the money with which the speculator starts. When once the public has learnt to distinguish between a speculation and an investment, and has also learnt honesty enough to be able to know whether it wants to speculate or invest, it will have gone much further towards checking the activity of the fraudulent promoter than any measure that can be recommended by the most respectable and industrious of committees. At the same time, it must be recognised by those responsible for our finance, that it is their business, and their interest,

to keep the City's back premises clean; because insanitary conditions in the back yard raise a stink which fouls the whole City.

In the meantime, if gossip is to be believed, some of the members of the Government have the most disquieting intentions concerning the kind of regulations which they wish to impose on the activities of the City, especially in its financial branch. It is believed that some of the bright young gentlemen who now rule us are in favour of Government control over the investment of money placed at home, and the prohibition of the issue of foreign securities; and it is even whispered that a fantastic scheme for controlling the profits of all industrial companies, by which anything earned above a certain level is to be seized for the benefit of the nation, is now a fashionable project in influential Parliamentary circles. Every one must, of course, admit that a certain amount of control will be necessary for some time after the war. It may not be possible at once to throw open the London Money Market to all borrowers, leaving them and it to decide between them who is to be first favoured with a supply of the capital for which there will be so large a demand when the war is over. Certain industries, those especially on which our export trade depends, will have to be first served in the matter of the provision of capital. If it is a choice between the engineering or shipbuilding trades and a company that wants to start an aeroplane service between London and Brighton for the idle rich, it would not be reasonable, during the first few months after the war, that the

unproductive project should be able, by bidding a high price for capital, to forestall the demand of the more useful producer. And with regard to the issue of foreign securities, there is this to be said, that foreign securities placed in London have the same effect upon foreign exchange as the import into England of goods shipped from any country; that is to say, for the time being they turn the exchange against us. On the other hand, it is a well-known commonplace that imports of securities have to be balanced by exports of goods or services; and as the times when our export trade is most active are those when most foreign securities are being placed in London, it follows that any restrictions placed upon the issue of foreign securities in London will hinder rather than help that recovery in our export trade which is so essential to the restoration of our position as a creditor country.

Moreover, our rulers must remember this, that in war-time, when all the letters sent abroad are subject to the eye of the Censor, it is possible to control the export of British funds abroad; but that in peace time (unless the censorship is to continue), it will not be possible to check foreign investment by restricting the issuing of foreign securities in London. If people see better rates to be earned abroad and more favourable prospects offered by the price of securities on foreign Stock Exchanges, they will invest abroad, whether securities are issued in London or not. As for the curious suggestion that the profits of industrial companies are henceforward to be limited and the whole balance above

a statutory rate to be taken over by the State for the public good, this would be, in effect, the continuance on stricter lines of the Excess Profits Duty. As a war measure the Excess Profits Duty has much to be said for it at a time when the Government, by its inflationary policy, is putting large windfalls of profit into the hands of most people who have to hold a stock of goods and have only to hold them to see them rise in value. The argument that the State should take back a large proportion of this artificially produced profit is sound enough ; but, if it is really to be the case that industry is to be asked for the future to take all the risk of enterprise and hand over all the profit above a certain level to the Government, the reply of industry to such a proposition would inevitably be short, emphatic, unprintable, and by no means productive of revenue to the State.

VIII

THE YEAR'S BALANCE-SHEET

April, 1918

The Figures of the National Budget—A Large Increase in Revenue and a Larger in Expenditure—Comparisons with Last Year and with the Estimates—The Proportions borne by Taxation still too Low—The Folly of our Policy of Incessant Borrowing—Its Injustice to the Fighting Men.

At first sight the figures of revenue and expenditure for the year ending March 31st are extremely satisfactory, at any rate on the revenue side. The Chancellor anticipated a year ago a revenue from taxation and State services of £638 millions, and the receipts into the Exchequer on these accounts actually amount to £707 millions. On the expenditure side, however, the increase over the Budget estimate was very much greater. The estimate was £2290 millions, and the actual amount expended was £2696 millions. Instead, therefore, of a deficit of £1652 millions having to be met by borrowing, there was an actual gap, to be filled by this method, of, roughly, £1990 millions.

To take the revenue side of the matter first, this being by far the most cheering and satisfactory, we find that the details of the revenue, as compared with last year's, were as follows :—

	Year ending Mar. 31, 1918. £	Year ending Mar. 31, 1917. £	Increase. £	Decrease. £
Customs	71,261,000	70,561,000	700,000	—
Excise	38,772,000	56,380,000	—	17,608,000
Estate, etc., Duties	31,674,000	31,232,000	442,000	—
Stamps	8,300,000	7,878,000	422,000	—
Land Tax	665,000	640,000	25,000	—
House Duty	1,960,000	1,940,000	20,000	—
Income Tax and Super-Tax	239,509,000	205,033,000	34,476,000	—
Excess Profits Duties, etc.	220,214,000	139,920,000	80,294,000	—
Land Value Duties	685,000	521,000	164,000	—
Postal Service	35,300,000	34,100,000	1,200,000	—
Crown Lands	690,000	650,000	40,000	—
Sundry Loans, etc.	6,056,250	8,055,817	—	1,999,567
Miscellaneous	52,148,315	16,516,765	35,631,550	—
	707,234,565	573,427,582	153,414,550	19,607,567
			£133,806,983 Net Increase.	

A more interesting comparison perhaps is to take the actual receipts during the past financial year and compare them, not with the former year, but with the estimates of the expected yield of the various items. In this case we get the following comparisons :—

	Actual. £	Estimated. £	Difference. £
Customs	71,261,000	70,750,000	+ 511,000
Excise	38,772,000	34,950,000	+ 3,822,000
Estate Duties	31,674,000	29,000,000	+ 2,674,000
Stamps	8,300,000	8,000,000	+ 300,000
Land Tax and House Duty	2,625,000	2,600,000	+ 25,000
Income Tax and Super Tax	239,509,000	224,000,000	+15,509,000
Excess Profits Tax	220,214,000	200,000,000	+20,214,000
Land Value Duties	685,000	400,000	+ 285,000
Postal Services	35,300,000	33,700,000	+ 1,600,000
Crown Lands	690,000	600,000	+ 90,000
Sundry Loans, etc.	6,056,000	7,500,000	+ 1,444,000
Miscellaneous	52,148,000	27,100,000	+25,048,000

Certainly, the country is entitled to congratulate itself on this tremendous evidence of elasticity of

revenue, and to a certain extent on the effort that it has made in providing this enormous sum of money from the proceeds of taxation and State services. But when this much has been admitted we have to hasten to add that the figures are not nearly so big as they look, and that there is much less " to write home about," as the schoolboy said, than there appears to be at first sight. Those champions of the Government methods of war finance who maintain that we have, during the past year, multiplied the pre-war revenue, of roughly, £200 millions by more than $3\frac{1}{2}$, so arriving at the present revenue of over £700 millions, are not comparing like with like. The statement is perfectly true on paper, and expressed in pounds sterling, but then the pound sterling of to-day is an entirely different article from the pre-war pound sterling. Owing to the system of finance pursued by our Government, and by every other Government now engaged in the war, of providing for a large part of the country's goods by the mere manufacture of new currency and credit, the buying power of the pound sterling has been greatly depreciated. By multiplying the amount of legal tender currency in the shape of Treasury notes, of token currency in the shape of silver and bronze coinage, and of banking currency through the bank deposits which are swollen by the banks' investments in Government securities, the Government has increased the amount of currency passing from hand to hand in the community while, at the same time, the volume of goods to be purchased has not been increased with anything like the same rapidity, and

may, in fact, have been actually decreased. The inevitable result has been a great flood of new money with a greatly depreciated value. Index numbers show a rise of over 100 per cent. in the average prices of commodities during the war. It is, however, perhaps unfair to assume that the buying power of the pound has actually been reduced by a half, but it is certainly safe to say that it has been reduced by a third. Therefore, the revenue raised by the Government during the past year has to be reduced by at least a third before we are justified in comparing our war achievements with the Government's pre-war revenue. If we take one-third off £707 millions it reduces the total raised during the past year by revenue to about £470 millions, less than two and a half times the pre-war revenue.

From another point of view our satisfaction with the tremendous figures of the past year's revenue has to be to some extent qualified. The great elasticity shown by the big increase of actual achievement over the Budget estimate has been almost entirely in revenue items which cannot be expected to continue to serve us when the war is over. The total increase in the receipts over estimate amounts to £69 millions, and of this £20 millions was provided by the Excess Profits Duty, a fiscal weapon which was invented during the war, and for the purpose of the war. It has always been assumed that it would be discontinued as soon as the war was over, and if it should not be discontinued its after-war effect is likely to be very unfortunate at a time when our industrial effort requires all the encouragement

that it can get. Another £25 millions was provided by miscellaneous revenue, and this windfall again must be largely due to operations connected with the war. Finally, the £15½ millions by which the income tax exceeded the estimate must again be largely due to inflation and extravagance on the part of the Government, which, by manufacturing money, and then spending it recklessly, puts big profits and big incomes into the hands of those who have stocks of goods to sell or who are in a position to produce them.

If, therefore, the satisfaction with which we regard the big total of the Government's revenue receipts has to be considerably modified in the cold light of close observation, the enormous increase on the expenditure side gives us very little comfort and calls for the most determined and continued criticism if our reckless Government is to be made to turn over a new leaf. In the early days of the war there was much excuse for wasting money. We had to improvise a great Army, and a great organisation for equipping it; there was no time then to look too closely into the way the money was being spent, but this excuse is long obsolete. It is not possible to waste money without also wasting the energy and working power of the nation; on this energy and working power the staying power of the country depends in its struggle to avert the greatest disaster that can be imagined for civilisation, that is, the victory of the German military power. Seeing that for many months past we have no longer been obliged to finance Russia, and to provide Russia

with the mass of materials and the equipment that she required, the way in which our expenditure has mounted up during the course of the year is a very serious blot on the year's balance-sheet. We spent during the year ending March 31st, £2696 millions against £2198 millions in the previous year, an increase of close upon £500 millions ; £63 millions of this increase were due to interest on war debt, the rest of it was due to increased cost of the war, and few business men will deny that very many of these extra millions might have been saved if our rulers and our bureaucratic tyrants had been imbued with any real sense of the need for conserving the energy of the nation.

Much has been done by the Committee on National Expenditure to bring home to the Government opportunities for economy, and methods by which it can be secured. Can we be equally confident that much has been done by the Government to carry out the advice that has been given by this Committee ? The Treasury is frequently blamed for its inability to check the rapacity and extravagance of the spending Departments. It is very likely that the Treasury might have done more if it had not been led by its own desire for a short-sighted economy into economising on its own staff, the activity and efficiency of which was so absolutely essential to the proper spending of the nation's money. But when this has been admitted, the fact remains that the Treasury cannot, or can only with great difficulty, be stronger on the side of economy than the Chancellor of the Exchequer, and that the

task of the Chancellor of the Exchequer of imposing economy on a spendthrift War Cabinet is one of extreme difficulty. I hope it is not necessary to say that I do not urge economy from any sordid desire to save the nation's money if, by its spending, victory could be secured or brought a day nearer. I only urge it because I believe that the conservation of our resources is absolutely necessary to maintain our staying power, and that these resources are at present being scandalously wasted by the Government. Inter-departmental competition is still complained of in the latest report of the National Committee on Expenditure, and there seems to be still very little evidence that the Government Departments have yet possessed themselves of the simple fact that it is only out of these resources that victory can be secured, and that any waste of them is therefore a crime against the cause of liberty and progress.

It is possible that before these lines are in print the Chancellor will have brought in his new Budget, and therefore any attempt to forecast the measures by which he will meet next year's revenue would be even more futile than most other endeavours at prophecy. But from the figures of last year as they are before us we see once more that the proportion of expenditure raised by revenue still leaves very much to be desired; £707 millions out of, roughly, £2700 millions is not nearly enough. It is true that on the expenditure side large sums have been put into assets which may some day or other be recoverable, and it is therefore impossible to assume with any approach to accuracy what the

actual cost of the war has been for us during the past year. We have made, for instance, very large advances to our Allies and Dominions, and it need not be said that our advances to our own Dominions may be regarded as quite as good as if they were still in our own pockets; but in the case of our Allies, our loans to Russia are a somewhat questionable asset, and our loans to our other brothers-in-arms cannot be regarded as likely to be recoverable for some time to come, owing to the severity with which the war's pressure has been laid upon them. With regard to the other assets in which the Government has invested our money, such as factories, machinery, ships, supplies and food, etc., it is at least possible that considerable loss may be involved in the realisation of some of them. It is, however, possible that the actual cost of the war to us during the year that is past may turn out some day to have been in the neighbourhood of £2000 millions. If, on the other hand, we deduct from the £700 millions raised by revenue the £200 millions which represent the normal pre-war cost of Government to this country we find that the proportion of war's cost raised out of revenue is slightly over 25 per cent. This proportion must be taken with all reserve for the reasons given above, but in any case it is very far below the 47 per cent. of the war's cost raised out of revenue by our ancestors in the course of the Napoleonic wars.

It seems to me that this policy of raising so large a proportion of the war's cost by borrowing is one that commends itself to short-sighted politicians,

but is by no means in the interests of the country as a whole, or of the taxpayers who now and hereafter have to find the money for paying for the war. In so far as the war's needs have to be met abroad, borrowing abroad is to some extent inevitable if the borrowing nation has not the necessary resources and labour available to turn out goods for export to exchange against those which have to be purchased abroad, but in so far as the war's needs are financed at home, the policy of borrowing is one that should only be used within the narrowest possible limits. By its means the Government, instead of making the citizens pay by taxation for the war as it goes on, hires a certain number of them to pay for it by promising them a rate of interest, and their money back some day. The interest and the sinking fund for redemption have to be found by taxation, and so the borrowing process merely postpones taxation from the war period to the peace period. During the war period taxation can be raised comparatively easily owing to the patriotic stimulus and the simplification of the industrial problem which is provided by the Government's insatiable demand for commodities. When the days of peace return, however, there will be very grave disturbance and dislocation in industry, and it will have once more to face the problem of providing goods, not for a Government which will take all that it can get, but for a public, the demands of which will be uncertain, and whose buying power will be unevenly distributed, and difficult to calculate. The process, therefore, which postpones taxa-

tion during the war period to the peace period seems to be extraordinarily short-sighted from the point of view of the nation's economic progress. Recovery after the war may be astonishingly rapid if all goes well, but this can only happen if every opportunity is given to industry to get back to peace work with the least possible friction, and a heavy burden of after-war taxation, such as we shall inevitably have to face if our Chancellors of the Exchequer continue to pile up the debt charge as they have done in the past, will be anything but helpful to those whose business it will be to set the machinery of industry going under peace conditions.

As things are, if we continue to add anything like £2000 millions a year to the National Debt, it will not be possible to balance the after-war Budget without taxation on a heavier scale than is now imposed, or without retaining the Excess Profit Duty, and so stifling industry at a time when it will need all the fresh air that it can get. Apart from this expedient, which would seem to be disastrous from the point of view of its effect upon fresh industry, the most widely advertised alternative is the capital levy, the objections to which are patent to all business men. It would involve an enormously costly and tedious process of valuation, its yield would be problematical, and it might easily deal a blow at the incentive to save on which the supply of capital after the war entirely depends. A much higher rate of income tax, especially on large incomes, is another solution of the problem, and it also might obviously have most unfortunate

effects upon the elasticity of industry. A tax on retail purchases has much to be said in its favour, but against it is the inequity inseparable from the impossibility of graduating it according to the ability of the taxpayer to bear the burden ; and a general tariff on imported goods, though it would be welcomed by the many Protectionists in our midst, can hardly be considered as a practical fiscal weapon at a time when the need for food, raw material, and all the equipment of industry will make it necessary to import as rapidly and as cheaply as possible in order to promote our after-war recovery.

Apart from these purely economic arguments against the high proportion of the war's costs that we are meeting by borrowing, there is the much more important fact of its bad effect on the minds of our soldiers, and of those members of the civilian population who draw mistaken inferences from its effects. From the point of view of our soldiers, who have to go and fight for their country at a time when those who are left at home are earning high wages and making big profits, it is evidently highly unfair that the war should be financed by a method which postpones taxation. The civilian population left at home, earning high profits and high wages, should clearly pay as much as possible during the war by immediate taxation, so that the burden of taxation may be relieved for our soldiers when they return to civil life. In view of the hardships and dangers which our soldiers have to face, and the heroism with which they are facing them, this argument should be of overwhelming strength in the eyes of

every citizen who has imagination enough to conceive what our fighting men are doing for us and how supreme is our duty to do everything to relieve them from any other burden except those which the war compels them to face. There is also the fact that many members of our uninstructed industrial population believe that the richer classes are growing richer owing to the war, and battening on the proceeds of the loans. I do not think that this is true; on the contrary, I believe that the war has brought a considerable shifting of buying power from the well-to-do classes to the manual workers. Nevertheless, in these times misconceptions are awkwardly active for evil. The well-to-do classes as a whole are not really benefited by having their future incomes pledged in order to meet the future debt charge, and if, at the same time, they are believed to be acquiring the right to wealth, which wealth they will have themselves to provide, the fatuity of the borrowing policy becomes more manifest. For these reasons it is sincerely to be hoped that our next fiscal year will be marked by a much higher revenue from taxation, a considerable decrease in expenditure, and a consequently great improvement in the proportion of war's cost met out of revenue, on what has been done in the past year. At our present rate of taxation we are not nearly meeting, out of permanent taxes, the sum which will be needed when the war is over for peace expenditure on the inevitably higher scale, pensions, and interest and sinking fund on war debt.

IX

COMPARATIVE WAR FINANCE

May, 1918

The New Budget—Our own and Germany's Balance-sheets—The Enemy's Difficulties—Mr Bonar Law's Optimism—Special Advantages which Peace will bring to Germany—A Comparison with American Finance—How much have we raised from Revenue ?—The Value of the Pound To-day—The 1918 Budget an Improvement on its Predecessors—But Direct Taxation still too Low—Deductions from the Chancellor's Estimates.

One of the most interesting passages in a Budget speech of unusual interest was that in which the Chancellor of the Exchequer compared the financial methods of Germany and of this country, as shown by their systems of war finance. He began by admitting that it is difficult to make any accurate calculation on this subject, owing to the very thick mist of obscurity which envelops Germany's actual performance in the matter of finance since the war began. As the Chancellor says, our figures throughout have been presented with the object of showing quite clearly what is our financial position. Most of the people who are obliged to study the figures of Government finance would feel inclined to reply that, if this is really so, the Chancellor and the Treasury seem to have curiously narrow limitations in their capacity for clearness. Very few accountants, I

imagine, consider the official figures, as periodically published, as models of lucidity. Nevertheless, we can at least claim that in this respect the figures furnished to us by the Government during the war have been quite as lucid as those which used to be presented in time of peace, and it is greatly to the credit of the Treasury that, in spite of the enormous figures now involved by Government expenditure, the financial statements have been published week by week, quarter by quarter, and year by year, with the same promptitude and punctuality that marked their appearance in peace-time. In Germany, the Chancellor says, it has not been the object of German financial statements to show the financial position quite clearly. It is, therefore, difficult to make an exact statement, but he was able to provide the House with a series of very interesting figures, taken from the statements of the German Finance Ministers themselves.

His first point is with regard to the increase of expenditure. The alarming rate with which our expenditure has so steadily grown appears to be paralleled also in Germany. Up to June, 1916, Germany's monthly expenditure was £100 millions. It has now risen to over £187 millions. That means to say that their expenditure per diem is £6¼ millions, almost the same as ours, although our expenditure includes items such as separation allowances and other matters of that kind, borne by the States and municipalities in Germany, and so not appearing in the German imperial figures.

As to the precise extent of the German war debt,

there is no certainty, but the Chancellor was able to tell the House that the last German Vote of Credit, which was estimated to carry them on to June or July, brings the total amount of all their Votes of Credit to £6200 millions, and that it is at least certain that that amount has been added to their War Debt, because their taxation during the war has not covered peace expenditure plus debt charge. Up to 1916 they imposed no new taxation. In 1916 they imposed a war increment tax, something in the nature of a capital levy, which is stated to have brought in £275 millions. They added also that year £25 millions nominally to their permanent revenue. In 1917 they added in addition £40 millions to their permanent revenue. "Assuming, therefore, that their estimates were realised, the total amount of new taxation levied by them since the beginning of the war comes to £365 millions, as against our £1044 millions. This £365 millions is not enough to pay the interest upon the War Debt which had been accumulated up to the end of the year."

Mr Bonar Law then proceeded to give an estimate of what the German balance-sheet will be a year hence on the same basis on which he had calculated ours. With regard to our position, he had calculated that on the present basis of taxation we shall have a margin of four millions at the end of the present year if peace should then break out. As will be shown later, this estimate of his is somewhat optimistic, but at any rate our position, compared with that of Germany, may be described as

on velvet. A year hence the German War Debt will be not less than £8000 millions. The interest on that will be at least £400 millions, a sinking fund at ½ per cent. will be £40 millions. Their pension engagements, which will be much higher than ours owing to their far heavier casualties, have been estimated at amounts ranging as high as £200 millions. The Chancellor was sure that he was within the mark in saying that it will be at least £150 millions. Their normal pre-war expenditure was £130 millions, so that they will have to face a total expenditure at the end of the war of £720 millions. On the other side of the account their pre-war revenue was £150 millions. They have announced their intention of this year raising additional permanent Imperial revenue amounting to £120 millions. From the nature of the taxes the Chancellor considers it very difficult to believe that this amount will be realised, but, assuming that it is, it will make their total additional revenue £185 millions. That, added to the pre-war revenue, gives a total of £335 millions, showing "a deficit at the end of this year, comparing the revenue with the expenditure, of £385 millions at least." The Chancellor added that if that were our position he would certainly think that bankruptcy was not far from the British Government.

Another point that the Chancellor was able to make effectively, in comparing our war revenue with Germany's, was the fact that, with the exception of the war increment tax, scarcely any of the additional revenue has been obtained from the wealthier

classes in Germany. Taxation has been indirect and on commodities which are paid for by the masses of the people. "The lesson to be drawn from these facts is not difficult to see. The rulers of Germany, in spite of their hopes of indemnity, must realise that financial stability is one of the elements of national strength. They have not added to their financial stability." The reason for this failure the Chancellor considers to be largely psychological. It is, in the first place, because they do not care to add to discontent by increased taxation all over the country, but "it is still more due to this, that in Germany the classes which have any influence on or control of the Government are the wealthier classes, and the Government have been absolutely afraid to force taxation upon them."

It is certainly very pleasant to be able to contemplate the financial blunders by which Germany is so greatly increasing the difficulties that it will have to face before the war is over. On the other hand, we have to recognise that the Chancellor, with that incorrigible optimism of his, has committed the common but serious error of over-stating his case by leaving out factors which are in Germany's favour, as, for instance, that Germany's debt is to a larger extent than ours held at home. Since the war began we have raised over £1000 millions by borrowing abroad. Our public accounts show that the item of "Other Debt," which is generally believed to refer to debt raised abroad, now amounts to £958 millions, while one of our loans in America, which is separately stated in the account because

it was raised under a special Act, amounted to £51½ millions. It is also quite possible that fair amounts of our Treasury bills, perhaps also of our Temporary Advances and of our other war securities, have been taken up by foreigners; but quite apart from that the two items already referred to now amount to more than £1000 millions, though at the end of March last their amount was only £988 millions. It is also well known that we have during the course of the war realised abroad the cream of our foreign investments, American Railroad Bonds, Municipal and Government holdings in Scandinavia, Argentina, and elsewhere, to an amount concerning which no accurate estimate can be made, except by those who have access to the Arcana of the Treasury. It may, however, be taken as roughly true that so far the extent of our total borrowings and realisation of securities abroad has been balanced by our loans to our Allies and Dominions, which amounted at the end of March last to £1526 millions. We have thus entered into an enormous liability on foreign debts and sold a batch of very excellent securities on which we used to receive interest from abroad in the shape of goods and services, against which we now hold claims upon our Allies and Dominions, in respect to the greater part of which it would be absurd to pretend that we can rely on receiving interest for some years after the war, in view of the much greater economic strain imposed by the war upon our Allies.

Germany, of course, has been doing these things also. Germany has parted with her foreign

securities. She was selling them in blocks for some weeks before the war, and Germany, of course, has done everything that she could in order to induce neutrals, during the course of the war, to buy securities from her and to subscribe to her War Loans. Nevertheless, it cannot have been possible for Germany to carry out these operations to anything like the extent that we have, partly because her credit has not been nearly so good, partly because her ruthless and brutal conduct of the war has turned the sentiment of the world against her, and partly because the measures that we have taken to check remittances and transfers of money have not been altogether ineffective. On this side of the problem Germany has therefore an advantage over us, that her war finance, pitiful as it has been, has, not owing to any virtue of hers, but owing to force of circumstances, raised her a problem which is to a great extent internal, and will not have altered her relation to the finance of other countries so much as has been the case with regard to ourselves. We also have to remember that the process of demobilisation will be far simpler, quicker, and cheaper for Germany than for us. Even if the war ended to-morrow the German Army would not have far to go in order to get home, and we hope that by the time the war ends the German Army will all have been driven back into its own country and so will be on its own soil, only requiring to be redistributed to its peace occupations. Our Army will have to be fetched home, firstly, over Continental railways, probably battered into a condition of

much inefficiency, and then in ships, of which the supply will be very short. The process will be very slow and very costly. Our Overseas Army will have to be sent back to distant Dominions, and the Army of our American Allies will have to be ferried back over the Atlantic. Consequently if Germany is able to obtain anything like the supply of raw material that she requires she will be able to get back to peace business much more quickly than any of her Anglo-Saxon enemies, and this is an advantage on her side which it would be unwise to ignore in considering the bad effects on her after-war activities of the very questionable methods by which she has financed and is financing the war.

Since we are indulging in these comparisons, it may be interesting to consider how our American Allies are showing in this matter of war finance. The *Times*, in its "City Notes" of April 15th, observed, in connection with the unexpectedly small amount of the third Liberty Loan, that the reason why the smaller figure was adopted for the issue was that it seems quite certain now that the original estimate for the expenditure in the fiscal year ending June 30th next was much too high. This estimate was 18,775 million dollars. The *Times* stated that the realised amount is likely to be hardly more than 12,000 million dollars, of which about 4500 million dollars will represent loans to Allies, and that the estimate for the year's largely increased tax revenue was 3886 million dollars, which now seems likely to be exceeded by the receipts. If this be so, out of a total expenditure of £2400 millions, of which £900

millions will be lent to the Allies, the Americans are apparently raising nearly £800 millions out of revenue. Therefore if we deduct from both sides of the account the pre-war expenditure of about £215 millions and deduct also the loans to Allies from the expenditure, it leaves the cost of the war to America £1285 millions for this year and the war revenue £562 millions. If these figures are correct it would thus appear that America is raising nearly half its actual war cost out of revenue as the war goes on.

On the other hand, in the New York *Commercial Chronicle* of April 6th the total estimated disbursements for the year are still stated at over 16,000 million dollars, that is to say, £3200 millions roughly, so that there seems to be considerable uncertainty as to what the actual amount of the expenditure of the United States will be during the year ending on June 30th. In any case, there can be no question that if the very high proportion of war cost paid out of revenue shown by the *Times* figures proves to be correct, it will be largely owing to accident or misfortune; if America's war expenditure has not proceeded nearly as fast as was expected, it will be, no doubt, owing not to economies but to shortcomings in the matter of delivery of war goods which the Government had expected to pay for in the course of the fiscal year. It certainly would have been expected that the Americans would in this matter of war finance be in a position to set a very much higher standard than any of the European belligerents owing to the enormous wealth that the

country has acquired during the two and a half years in which it, in the position of a neutral, was able to sell its produce at highly satisfactory prices to the warring Powers without itself having to incur any of the expenses of war. On the other hand, its great distance from the actual seat of operations will naturally make it difficult for the American Government to impose taxation as freely as might have been done in the case of peoples which are actually on the scene of warfare; so that it is hardly safe to count on American example to improve the standard of war finance which has been so lamentably low in Europe in the course of the present war. According to their original estimates the proportion of war cost borne out of taxation seems to have been on very much the same level as ours, and this has all through the war been very much lower than the results achieved by our ancestors at the time of the Napoleonic and Crimean wars.

On this point the proportion of our expenditure, which has been borne out of revenue, the Chancellor stated that up to the end of last financial year, March 31, 1918, the proportion of total expenditure borne out of revenue was 26·3 per cent. On the estimates which he submitted to the House in his Budget speech on April 22nd, the proportion of total expenditure met out of revenue during the current financial year will be 28·3 per cent., and the proportion calculated over the whole period to the end of the current year will be 26·9 per cent. These proportions, however, are between total revenue and total expenditure during the war period. The

proportion, of course, is not so high when we try to calculate actual war revenue and war expenditure by deducting on each side at a rate of £200 millions a year as representing normal expenditure and revenue and leaving out advances to Allies and Dominions. On this basis the proportion of war expenditure met out of war revenue up to March 31, 1918, was, the Chancellor stated, 21·7 per cent. For the year 1917–18 it was 25·3 per cent., for the current year it will be 26·5 per cent., and for the whole period up to the end of the current year 23·3 per cent. The corresponding figures for the Napoleonic and Crimean wars are given by Sir Bernard Mallet in his book on British Budgets as 47 per cent. and 47·4 per cent. So that it will be seen that, judged by this test, our war finance, though very much better than Germany's, is not on so high a standard as that set by previous wars. It is true, of course, that the rate of expenditure during the present war has been on a scale which altogether dwarfs the outgoing in any previous struggle. The Napoleonic War is calculated to have cost some £800 millions, having lasted some twenty-three years. Last year we spent £2696 millions, of which near £2000 millions may be taken as war cost, after deducting normal expenditure and loans to Allies.

Nevertheless, this argument of the enormous cost of the present war does not seem to me to be a good reason why the war should be financed badly, but rather a reason for making every possible effort to finance it well. Are we doing so? At first sight it is a great achievement to have increased our total

revenue from £200 millions before the war to £842 millions, the amount which we are expected to receive during the current year on the basis of the proposed additions to taxation, without taking into account any revenue from the suggested luxury tax. But, as I have already pointed out, the comparison of war pounds with pre-war pounds is in itself deceptive. The pounds that we are paying to-day in taxation are by no means the pounds that we paid before the war; their value in effective buying power has been diminished by something like one half. So that even with the proposed additions to taxation we shall not have much more than doubled the revenue of the country from taxation and State services as calculated in effective buying power. When we consider how much is at stake, that the very existence, not only of the country but of civilisation, is endangered by German aggression, it cannot be said that in the matter of taxation the country is doing anything like what it ought to have done or anything like what it would have done, willingly and readily, if a proper example had been set by the leading men among us, and if the right kind of financial lead had been given to the country by its rulers.

When we look at the details of the Budget, it will be seen that the Chancellor has made a considerable advance upon his achievement of a year ago, when he imposed fresh taxation amounting to £26 millions, twenty of which came from excess profits duty, and could therefore not be counted upon as permanent, in his Budget for a year which was

expected to add over £1600 millions to the country's debt, and actually added nearly £2000 millions. For the present year he anticipates an expenditure of £2972 millions, and he is imposing fresh taxation which will realise £68 millions in the current year and £114½ millions in a full year. On the basis of taxation at which it stood last year he estimates for an increase of £67 millions, income tax and super-tax on the old basis being expected to bring in £28 millions more, and excess profits duty £80 millions more, against which decreases were estimated at £3½ millions in Excise and £37 millions in miscellaneous. He thus expects to get a total increase on the last year's figures of £135 millions, making for the current year a total revenue of £842 millions, and leaving a total deficit of £2130 millions to be provided by borrowing. Increases in taxation on spirits, beer, tobacco, and sugar bring in a total of nearly £41 millions. An increase of a penny in the stamp duty on cheques is estimated to bring in £750,000 this year and a million in a full year, and the increases in the income tax and the super-tax will bring in £23 millions in the present year and £61 millions in a full year. Increases in postal charges will bring in £3½ millions this year and £4 millions in a full year.

There has been little serious criticism of these changes in taxation except that many people, who seem to regard the penny post as a kind of fetish, have expressed regret that the postal rate of the letter should be raised to 1½*d*. This addition seems to me to be merely an inadequate recognition of the

depreciation of the buying power of the penny and to be fully warranted by the country's circumstances. Either it will bring in revenue or it will save the Post Office labour, and whichever of these objects is achieved will increase the country's power to continue the war. The extra penny stamp on cheques has been rather absurdly objected to as being likely to increase inflation. Since the effect of it is likely to be that people will draw a smaller number of small cheques, and will make a larger number of their purchases by means of Treasury notes, the tax will merely result in the substitution of one form of currency for another, and it is difficult to see how this process will in any way increase inflation. Other arguments might be adduced, which make it undesirable to increase the outstanding amounts of Treasury notes, but in the matter of inflation through addition to paper currency, it seems to me that the proposed tax is entirely blameless. The increase of a shilling in income tax and super-tax produced a feeling of relief in the City, being considerably lower than had been anticipated. It is hardly the business of the Chancellor of the Exchequer in this most serious crisis to produce feelings of relief among the taxpayers, and it seems to me a great pity that he did not make much freer use of these most equitable forms of taxation, having first made arrangements (which could easily have been done) by which their very severe pressure would have been relieved upon those who have families to bring up. Death duties, again, he altogether omitted as a source of extra revenue. His

proposed luxury tax he has left to be evolved by the wisdom of a House of Commons Committee, and has thereby given plenty of time to extravagantly minded people to lay in a store of stuff before the tax is brought into being.

Space will not allow me to deal fully with the Chancellor's very interesting analysis of our position as he expects it to be at the end of the financial year on the supposition that the war was then over. He expects a revenue then of £540 millions on the present basis, making, with the yield of the new taxes in a full year, £654 millions in all, without including the excess profits duty, and he expects an after-war expenditure of £650 millions, including £50 millions for pensions and £380 millions for debt charge. It seems to me that his expectation of after-war revenue is too high, and of after-war expenditure is too low. He says that the estimates have been carefully made, but that they include "a recovery from the absence of war conditions," but surely the absence of war conditions is much more likely to produce a diminution than a recovery in taxation. Under the present circumstances, with prices continually rising, the profits of those who grow or hold stocks of goods of any kind automatically swell. The rise in prices has only to cease, to say nothing of its being turned into a fall, to produce at once a big check in those profits, and when we consider the enormous dislocation likely to be produced by the beginning of the peace period expectations of an elastic revenue when the war is over seem to be almost criminally optimistic.

The Chancellor arrived at his after-war debt charge of £380 millions by estimating for a gross debt on March 31, 1919, of £7980 millions, which he reduces to a net debt of £6856 millions by deducting half the expected face value of loans to Allies, £816 millions, and £308 millions for loans to Dominions and India's obligation. But is he, in fact, entitled to count on receiving any interest at all from our Allies for some years to come after the war? If not, then on that portion of our debt which is represented by loans to Allies we shall have to meet interest for ourselves. He also gave an imposing list of assets in the shape of balances in hand, foodstuffs, land, securities, building ships, stores in munitions department, and arrears of taxation, amounting in all to nearly £1200 millions. It is certainly very pleasant to consider that we shall have all these valuable assets in hand; but against them we have to allow, which the Chancellor altogether omitted to do, for the big arrears of expenditure and the huge cost of demobilisation, which is at least likely to absorb the whole of them. On the whole, therefore, although we can claim that our war finance is very much better than that of our enemies, it is difficult to avoid the conclusion that it might have been very much better than it is, and that it is not nearly as good as it is represented to be by the optimistic fancy of the Chancellor of the Exchequer.

X

INTERNATIONAL CURRENCY

June, 1918

An Inopportune Proposal—What is Currency ?—The Primitive System of Barter—The Advantages possessed by the Precious Metals—Gold as a Standard of Value—Its Failure to remain Constant—Currency and Prices—The Complication of other Instruments of Credit—No Substitute for Gold in Sight—Its Acceptability not shaken by the War—A Fluctuating Standard not wholly Disadvantageous—An International Currency fatal to the Task of Reconstruction—Stability and Certainty the Great Needs.

As if mankind had not enough on its hands at the present moment, a number of well-meaning people seem to think that this is an opportune time for raising obscure questions of currency, and trying to make the public take an interest in schemes for bettering man's lot by improving the arrangements under which international payments are carried out. Nobody can deny that some improvement is possible in this respect, but it may very well be doubted whether, at the present moment, when very serious problems of rebuilding have inevitably to be faced and solved, it is advisable to complicate them by introducing this difficult question which, whenever it is raised, will require the most careful and earnest consideration.

Since, however, the question is in the air, it may

be as well to consider what is wrong with our present methods, and what sort of improvements are suggested by the reformers. At present, as every one knows, international payments are in normal times ultimately settled by shipments from one country to another of gold. Gold has achieved this position for reasons which have been described in all the currency text-books. Mankind proceeded from a state of barter to a condition in which one particular commodity was used as the chief means of payment simply because this process was found to be much more convenient. Under a system of barter an exchange could only be effected between two people who happened to be possessed each of them of the thing which the other one wanted, and also at the same time to want the thing which the other one possessed, and the extent of their mutual wants had to fit so exactly that they were able to carry out the desired exchange. It must obviously have been rare that things happened so fortunately that mutually advantageous exchanges were possible, and the text-books invariably call attention to the difficulties of the baker who wanted a hat, but was unable to supply his need because the hatter did not want bread but fish or some other commodity.

It thus happened that we find in primitive communities one particular commodity of general use being selected for the purpose of what is now called currency. It is very likely that this process arose quite unconsciously; the hatter who did not want bread may very likely have observed that the baker had something, such as a bit of leather, which was

more durable than bread, and which the hatter could be quite certain that either he himself would want at some time, or that somebody else would want, and he would therefore always be able to exchange it for something that he wanted. All that is needed for currency in a primitive or any other kind of people is that it should be, in the first place, durable, in the second place in universal demand, and, in the third place, more or less portable. If it also possessed the quality of being easily able to be subdivided without impairing its value, and was such that the various pieces into which it was subdivided could be relied on not to vary in desirability, then it came near to perfection from the point of view of currency.

All these qualities were possessed in an eminent degree by the precious metals. It is an amusing commentary on the commonly assumed material outlook of the average man that the article which has won its way to supremacy as currency by its universal desirability, should be the precious metals which are practically useless except for purposes of ornamentation. For inlaying armour and so adorning the person of a semi-barbarous chief, for making into ornaments for his wives, and for the embellishment of the temples of his gods, the precious metals had eminent advantages, so eminent that the practical common sense of mankind discovered that they could always be relied upon as being acceptable on the part of anybody who had anything to sell. In the matter of durability, their power to resist wear and tear was obviously much greater than that of

the hides and tobacco and other commodities then fulfilling the functions of currency in primitive communities. They could also be carried about much more conveniently than the cattle which have been believed to have fulfilled the functions of currency in certain places, and they were capable of subdivision without any impairing of their value, that is to say, of their acceptability. Merely as currency, precious metals thus have advantages over any other commodity that can be thought of for this purpose.

So far, however, we have only considered the needs of man for currency; that is to say, for a medium of exchange for the time being. It is obvious, however, that any commodity which fulfils this function, that is to say, is normally taken in payment in the exchange of commodities and services, also necessarily acquires a still more important duty, that is, it becomes a standard of value, and it is on the alleged failure of gold to meet the requirements of the standard of value that the present attack upon it is based. On this point the defenders of the gold standard will find a good deal of difficulty in discovering anything but a negative defence. The ideal standard of value is one which does not vary, and it cannot be contended that gold from this point of view has shown any approach to perfection in fulfilling this function. It could only do so if the supply of it available as currency could by some miracle be kept in constant relation with the supply of all other commodities and services that are being produced by mankind. That it should be constant

with each one of them is, of course, obviously impossible, since the rate at which, for example, wheat and pig-iron are being produced necessarily varies from time to time as compared with one another. Variations in the price of wheat and pig-iron are thus inevitable, but it can at least be claimed by idealists in currency matters that some form of currency might possibly be devised, the amount of which might always be in agreement with the amount of the total output of saleable goods, in the widest sense of the word, that is being created for man's use.

It need not be said that this desirability of a constant agreement between the volume of currency and the volume of goods coming forward for exchange is based on what is called the quantitative theory of money. This theory is still occasionally called in question, but is on the whole accepted by most economists of to-day, and seems to me to be a mere arithmetical truism if we only make the meaning of the word "currency" wide enough; that is to say, if we define it as including all kinds of commodities, including pieces of paper and credit instruments, which are normally accepted in payment for goods and services. This addition of credit instruments, however, is a complication which has considerably confused the problem of gold as the best means of ultimate payment. Taken simply by itself the quantitative theory of money merely says that if money of all kinds is increased more rapidly than goods, then the buying power of money will decline, and the prices of goods will go up and vice versa.

This seems to be an obvious truism if we make due allowance for what is called the velocity of circulation. If more money is being produced, but the larger amount is not turned over as rapidly as the currency which was in existence before, then the effect of the increase will inevitably be diminished, and perhaps altogether nullified. But other things being equal, more money will mean higher prices, and less money will mean lower prices.

But, as has been said, the question is very greatly complicated by the addition of credit instruments to the volume of money, and this complication has been made still more complicated by the fact that many economists have refused to regard as money anything except actual metal, or at least such credit instruments as are legal tender, that is to say, have to be taken in payment for commodities, whether the seller wishes to do so or not. For example, many people who are interested in currency questions would regard at the present moment in this country gold, Bank of England notes, Treasury notes, and silver and copper up to their legal limits as money, but would deny this title to cheques. It seems to me, however, that the fact that the cheque is not and cannot be legal tender does not in practice affect or in any way impair the effectiveness of its use as money. As a matter of fact cheques drawn by a good customer of a good bank are received all over the country day by day in payment for an enormous volume of goods. In so far as they are so received, their effect upon prices is exactly the same as that of legal tender currency. This fact is

now so generally recognised that the Committee on National Expenditure has called attention to the financing of the war by bank credits as one of the reasons for the inflation of prices which has done so much to raise the cost of the war. It is, in fact, being generally recognised that the power of the bankers to give their customers credits enabling them to draw cheques amounts in fact to an increase in the currency just as much as the power of the Bank of England to print legal tender notes, and the power of the Government to print Treasury notes.

Thus it has happened that by the evolution of the banking system the use of the precious metals as currency has been reinforced and expanded by the printing of an enormous mass of pieces of paper, whether in the form of notes, or in the form of cheques, which economise the use of gold, but have hitherto always been based on the fact that they are convertible into gold on demand, and in fact have only been accepted because of this important proviso. Gold as currency was so convenient and perfect that its perfection has been improved upon by this ingenious device, which prevented its actually passing from hand to hand as currency, and substituted for it an enormous mass of pieces of paper which were promises to pay it, if ever the holders of the paper chose to exercise their power to demand it. By this method gold has been enabled to circulate in the form of paper substitutes to an extent which its actual amount would have made altogether impossible if it had had to do its circulation, so to

speak, in its own person. From the application of this great economy to gold two consequences have followed; the first is that the effectiveness of gold as a standard of value has been weakened because this power that banks have given to it of circulating by substitute has obviously depreciated its value by enormously multiplying the effective supply of it. Depreciation in the buying power of money, and a consequent rise in prices, has consequently been a factor which has been almost constantly at work for centuries with occasional reactions, during which the process went the other way. Another consequence has been that people, seeing the ease with which pieces of paper can be multiplied, representing a right to gold which is only in exceptional cases exercised, have proceeded to ask whether there is really any necessity to have gold behind the paper at all, and whether it would not be possible to evolve some ideal form of super-paper which could take the place of gold as the basis of the ordinary paper which is created by the machinery of credit, which would be made exchangeable into it on demand instead of into gold.

It is difficult to say how far the events of the war have contributed to the agitation for the substitution for gold of some other form of international currency. It would seem at first sight that the position of gold at the centre of the credit system has been shaken owing to the fact that in Sweden and some other neutral countries the obligation to receive gold in payment for goods has been for the time being abrogated. The critics of the gold

standard are thus enabled to say, "See what has happened to your theory of the universal acceptability of gold. Here are countries which refuse to accept any more gold in payment for goods. They say, 'We do not want your gold any more. We want something that we can eat or make into clothes to put on our backs.'" This is certainly an extremely curious development that is one of the by-products of war's economic lessons. But I do not feel quite sure that it has really taught us anything new. All that has ever been claimed for gold is that it is universally acceptable when men are buying and selling together under more or less normal circumstances. It has always been recognised that a shipwrecked crew on a desert island would be unlikely to exchange the coco-nuts or fish or any other commodities likely to sustain life which they could find, for any gold which happened to be in the possession of any of them, except with a view to their being possibly picked up by a passing ship, and returning to conditions under which gold would reassume its old privilege of acceptability.

During the war the shipping conditions have been such that many countries have been hard put to it, especially if they were contiguous to nations with which the Entente is at present at war, to get the commodities which they needed for their subsistence. The Entente, with its command of the sea, has found it necessary to ration them so that they should have no available surplus to hand on to the enemy. They have very naturally endeavoured to resist these measures, and in order to do so have made use of

the power that they exercise by their being in possession of commodities which the Entente desires. They have shown a tendency to say that they would not part with these commodities unless the Entente allowed them to have a larger proportion of things needed for subsistence than the Entente thought necessary for them, and it was as part of this battle for larger imports of necessaries that gold has been to some extent looked upon askance as means of payment, the preference being given to things to eat and wear rather than to the metal. These wholly abnormal circumstances, however, do not seem to me to be any proof that gold will after the war be any less acceptable as a means of payment than before. The Germans are usually credited with considerable sagacity in money matters, with rather more, in fact, I am inclined to think, than they actually possess; they, at any rate, show a very eager desire to collect together and hold on to the largest possible store of gold, obviously with a view to making use of it when the war is over in payment for raw materials, and other commodities of which they are likely to find themselves extremely short. America also has shown a strong tendency to maintain as far as possible within its borders the enormous amount of gold which the early years of the war poured into its hands. While such is the conduct of the chief foreign nations, it is also interesting to note that one comes across a good many people who, in spite of all the admonitions of the Government to all good citizens to pay their gold into the banks, still hold on to a small store of sovereigns in the

fear of some chain of circumstances arising in which only gold would be taken in payment for commodities. On the whole, I am inclined to think that the power of gold as a desirable commodity merely because it is believed to be always acceptable has not been appreciably shaken by the events of the war.

This does not alter the fact that, as has been shown above, gold, complicated by the paper which has been based upon it, cannot claim to have risen to full perfection as a standard of value. In primitive times the question of the standard of value hardly arises. Transactions are for the most part carried out and concluded at once, and any seller who takes a piece of metal in payment for his goods does so with the rough knowledge of what that piece of metal will buy for him at the moment, and that is the only point which concerns him. The standard of value only becomes important when under settled conditions of society long-term contracts bulk large in economic transactions. A man who makes an investment which entitles him to 5 per cent. interest, and repayment in 30 years' time, begins to be very seriously interested in the question of what command over commodities his annual income of 5 per cent. will give him, and whether the repayment of his money at the end of 30 years will represent the repayment of anything like the same amount of buying power as his money now possesses. It is here, of course, that gold has failed because, as we have seen, the process has been a fairly steady one of depreciation in the buying

power of the alleged standard and a rise in the prices of other commodities. This means to say that the investor who has accepted repayment at the end of 30 years of the amount that he lent, be it £100 or £10,000, has found that the money repaid to him had by no means the same buying power as the money which he originally invested.

Within limits this tendency of the standard of value towards depreciation has possessed considerable advantages, probably much greater advantages than would have followed from the contrary process if it had been the other way round. If we can imagine that the currency history of the world had been such that a constantly diminished quantity of currency in relation to the output of other commodities had caused a steady fall in prices, it is obvious that there might have been a very considerable check to the enthusiasm of industry. It has indeed been contended that the scarcity of precious metals which, with the absence of an organised credit system, produced this result during the later Roman Empire was a very important cause of the decay into which that Empire fell. I do not feel at all convinced that this effect would necessarily have followed the cause. It seems to me that the ingenuity of enterprising man is such that the producer might, and probably would, have found means for facing the probability of depreciation in price. But it is always an empty pastime to try to imagine what would have happened "if things had been otherwise." What we do know is that a period of rising prices, especially if the rise does not go too

fast, stimulates the enterprise of producers, and sets business going actively, and consequently it may at least be claimed that the failure of the gold standard to maintain that steadiness of value which is an obvious attribute of the ideal standard has at least been a failure on the right side, by tending to depreciation of the value of currency, and so to a rise of the prices of other commodities. Obviously, people will tuck up their sleeves more readily to the business of production and manufacture if the course of the market in the product which they hope to sell some day is likely to be in their favour rather than against them.

And when all is admitted concerning the failure of the existing standard of value, the question is, what substitute can we find which will carry with it all the advantages that gold has been shown to possess, and at the same time maintain that steadiness of value which gold has certainly lacked? We hear airy talk of an international currency based on the credit of the nations leagued together to promote economic peace. It is certainly very obvious that the diplomatic relations of the world require complete reform, and the system by which the nations at present settle disputes between themselves has been found by the experience of the last four years to be so disgusting, so barbarous and so ridiculous that all the most civilised nations of the world are determined to go on with it until it is stopped for ever. Nevertheless, obvious as it is that some kind of a League of Nations is essential as a form of international police if civilisation is to be rescued

from destruction, it is very doubtful whether such an organisation could, at least during the first half-century or so of its existence, be called upon to tackle so difficult a question as that of the creation of an international currency based on international credit. In the first place, what will be required more than anything else after the war in economic matters will be the elimination of all possible reasons for uncertainty; so much uncertainty and difficulty will be inevitable that it seems to me to be almost criminal to add to those uncertainties by an outburst of eloquence on the part of currency reformers if there were any danger of their recommendations being accepted. It will be difficult enough to know where the producers of the world are to get raw material, find efficient labour, and then find a market for their products, without at the same time upsetting their minds with doubts concerning some kind of new-fangled currency that is to be created, and in which they are to be made to accept payment, with the possibilities of changes in the system which may have to be effected owing to some quite unforeseen results happening from its adoption. The gold standard, with all its failures, we do know; we also know that something may be done some day to remedy them if mankind can produce a set of rulers capable of approaching the question with all the knowledge and experience required; but to substitute this system at a time of great uncertainty for one which might or might not work would seem to be tempting Providence in an entirely unnecessary manner at a time when it is above all necessary

to get the economic ship as far as possible on an even keel.

If the proposed substitute is to succeed it will have to be at least as acceptable as gold, and at the same time its quantity must be so regulated as to be at all times constant in relation to the output of commodities. Can we pretend that the economic enlightenment of mankind has yet reached a point at which such a currency could be produced and regulated by the Governments of the world and be accepted by their citizens ?

XI

BONUS SHARES

July, 1918

A Deluge of Bonus Shares—The Effect on the Market—A Problem in Financial Psychology—The Capitalisation of Reserves—The Stock Exchange View—The Issue of Bonus-carrying Shares—The Case of the A.B.C.—A Wiser Variation from Canada—Bonus Shares on Flotation—An American Device—Midwife or Doctor ?—The Good and Bad Points of Both Systems.

Of the many kinds of Bonus shares, the one which has lately been most prominent in the public eye is that which is produced by the capitalisation of a reserve fund. There has lately been a perfect epidemic of this kind of Bonus share, which is almost as plentiful as the caterpillars in the oak trees and the green fly on the allotments. The reason for this outburst is apparently the anxiety which the directors of many prosperous industrial companies feel lest the high dividends which good management and sound finance in the past have enabled them to pay should lay them open to misunderstanding and attack by well-meaning people who think that it is a crime for a company to earn more than a certain percentage on its capital.

This explanation was very frankly given by the

directors of Brunner, Mond and Company, when they lately capitalised part of their reserves. The company, they stated, has for many years paid a dividend on its Ordinary shares of $27\frac{1}{2}$ per cent., and "the directors feel that there is a widespread impression that this is the rate of profit earned on the total of the capital invested, and consequently that the company is making an unfair profit out of its customers and the labour it employs. This is by no means the case." It is a lamentable proof of the backward state of the economic education of this country that it should be necessary for well-financed and prosperous concerns to take steps to make it quite clear to the public that they are not earning more than they appear to be. In a well-educated community it would be perceived at once that it is the well-financed and prosperous companies which improve production in the interests of their shareholders, their workmen, and the public; that the price which the public pays for a commodity is ultimately the price at which the worst financed and worst managed companies can just manage to keep alive; that the higher profits earned by the better companies are not wrung out of the pockets of the community, or their workmen, but are the result of good management and good finance; and that the more the good companies are encouraged to go ahead and drive the bad ones out of existence, the better will the community be served, and the better will be the chance of the workmen to get good wages. These platitudes are, of course, only true in a state of free competition. If there is anything like

monopoly the public and the workers are fully justified in being suspicious and examining the source from which high dividends are produced.

Such being the reason why this outburst of capitalisation of reserves first began—since in these days all capitalists and those who have to manage capital feel that they are working under criticism, which is not only jealous and suspicious (as it should be), but is also too often both ignorant and prejudiced—it is interesting to note that the movement which was so started has been stimulated by its very exhilarating effect on the market in the shares of the companies concerned. Why this should be so it is difficult at first sight to say. What happens is merely this—that a company, let us suppose, for the sake of simplicity, with a capital consisting wholly of 3,000,000 Ordinary shares, has accumulated out of past profits, or out of premiums on new issues of shares, a reserve fund of £1,000,000. Its net profit has lately averaged £400,000, and it has, year by year, distributed £300,000 in the shape of a 10 per cent. dividend to its shareholders, and put £100,000 into its reserve fund, which is represented on the other side of the balance-sheet by buildings and plant and a certain amount of first-class investments. If the directors now decide to capitalise that £1,000,000 of reserve fund, the only effect is that each shareholder will be given one new share for every three which he holds in the existing capital, the reserve fund will be wiped out, and the ordinary capital will be increased from £3,000,000 to £4,000,000. None of the shareholders will be in

actual fact better off to the extent of one halfpenny, because all will be in the same position with regard to one another; their relative shares in the enterprise will not have been altered. If we imagine, by way of simplifying the problem, that all the Ordinary shares were in one hand, that one holder would have had in his Ordinary shares a claim to the total assets of the company, that is to say, to its earning power as long as it is a going concern, and to whatever its assets realise if it went into liquidation; the fact that £1,000,000 worth of the assets had been bought out of past profits or premiums paid on new issues of shares would have already added to the value of the claim that he had on the property of the company, and no addition would be made to that value by turning the reserve fund into shares.

In other words, the reserve fund is already the property of the shareholders, and to convert it from reserve fund into capital, making them a present of new shares, which merely represent their claim to the assets held against the reserve fund, is as empty a gift as presenting a man with a piece of paper informing him that he is the owner of his own hat. All this remains equally true if, besides the ordinary capital, there is a considerable amount outstanding of Preference shares and Debenture debt. In any case, the Ordinary shareholders possess a claim to the earning power of the company when prior charges have been satisfied, and to whatever surplus may remain on liquidation after first charges have been paid off in full. Whether that interest of theirs is

represented by a larger or smaller number of shares, or by shares of a larger or smaller denomination, or by a reserve fund upon which they have a claim when all other claims have been settled makes no difference whatever as a matter of academic fact. Apart from the sentiment of the matter, there is no reason why ordinary capital should have any nominal value.

As to the earning power of the company, that, of course, is not affected one whit by the process. The earning power of the company is all in the assets—the plant, machinery and other property—plus the elusive qualities which are bound up in the word "goodwill," representing the selling power, organisation, and the expectation of future profits. The capitalisation of the reserve simply affects the manner in which the liabilities of the company are arranged, and the existence of a reserve fund merely means that the Ordinary shareholders have a claim to a larger amount than their nominal holding in case of liquidation. It does not matter in the least whether this larger claim is handed to them in the shape of a certificate, since the nominal amount of their claim has nothing whatever to do with the amount that their claim realises to them annually in the shape of dividends, or in the event of liquidation, from the realisation of the company's assets.

In fact, the capitalisation of reserves is sometimes criticised by economic purists as a retrograde step because it seems likely to encourage the directors to be extravagant in the matter of dividends. In the example which we supposed above of the company

with a capital of three millions and reserve fund of one million, if the reserve fund is turned into Ordinary shares and the earning power of the company remains the same there may obviously be a temptation to the directors to modify the prudent policy under which they had hitherto placed one hundred thousand a year to reserve, because if they continued it the shareholders would discover they were really no better off and that they simply got a lower rate of dividend on the larger amount of shares, and that their actual receipts from the company were exactly the same as before. And if the earning power of the company remained the same and the directors left off placing the one hundred thousand a year to reserve, and paid away the whole of the net profit in dividend, it is clear that the progressive expansion of the company's business would be to that extent checked. On the other hand, there is a contrary argument that as long as the company has a large reserve fund there is a possibility that dissatisfied shareholders may agitate for a realisation of sufficient assets to enable that reserve fund to be distributed, especially if it has been wholly acquired out of past profits. In this case the capitalisation of the reserve fund puts this temptation out of their reach since, when once the reserve fund has been capitalised, it can only be got at by greedy shareholders through the process of liquidation. Since, however, the shareholder in these times is not quite so short-sighted as he used to be, there is not perhaps really very much advantage in this point.

But since, as has been shown, capitalisation of reserves has no effect upon the earning power and assets of the company, it is interesting to try and discover why the rumour and announcement of such an intention on the part of the board of directors is nearly always accompanied by a rise in the shares of the company affected. If the shareholder is merely to be given a larger nominal claim, which does not in the least affect the value of the assets which that claim concerns, and if the relative amount of his claim is exactly the same with regard to the other shareholders, it is clear that the rise in the value of the shares is based entirely either on a psychological mistake on the part of the public and its financial advisers, or on the fact that the transaction called attention to the value of the shares which have hitherto been undervalued in the market. Probably the movement arises from both these causes. A large number of people think they are better off if they have a larger nominal share, without considering that all the other shareholders are at the same time having their claim increased, that the assets to which they all have a claim are not being increased, and that, consequently, if a sharing-out process were to take place they would all be exactly as they would have been if no such capitalisation of reserves had been carried out. And if a sufficient number of people think that a share or any other commodity is more valuable, it thereby becomes more valuable, because value is nothing else than the amount, whether in money or other commodities, at which a commodity can be disposed of.

But it is also true that there are, at all times, a very large number of securities, especially in the industrial market, which would stand higher if their earning power and position were more closely scrutinised. This is very clearly seen to be the case from the apparently extravagant prices at which insurance companies, for example, sometimes buy the businesses of one another. They give a price which is considerably above the market value of the concern as represented by the price of its shares. Critics say that the terms are extravagant, and yet the deal is found to be highly profitable to the buying company. The profit of the deal, of course, may be increased by the advantages of amalgamation, but quite apart from that it is clear that the market price of securities very often undervalues, as it also, perhaps, still oftener overvalues, the real position of the companies on whose earning powers they represent claims. In any case, there is the fact that these capitalisations of reserve funds, of the make no real difference to the actual position which company, are universally regarded, in the language of the Stock Exchange, as "bull points." It is assumed, of course, that the directors would not carry out such an operation unless they saw their way to a higher earning power in the future as a justification for the larger capital. In this expectation the directors might be right or wrong, and, even if they are right, that prospect of higher earning power, if market prices could be relied upon to express the true position of a company, would have been "in the price."

There is another kind of Bonus share, which is not exactly a Bonus share, but carries a bonus with it. This comes into being when the directors of a company sell new shares to existing shareholders at a price below the terms which they might have obtained if they made a new issue to the general public. The classical example of this system is the Aerated Bread Company, that concern to which City clerks and journalists and others owe so much as pioneers of cheap and simple catering. It will be remembered that in the palmy days of this company, before it had been severely cut into by competition, its £1 shares used to stand in the neighbourhood of £15. The directors used then to make issues of new shares to existing shareholders at their face value, that is to say, at £1 per share, although it was obvious that if they had made a public issue inviting all and sundry to subscribe they could have sold their new issues at or above £14 per share. This system put an enormous bonus in the pockets of the existing shareholders at the expense of the company and its future prospects. The directors practically gave to the existing shareholders a present of £130,000 if they sold them 10,000 new shares for £10,000, which they and the public would have readily subscribed for at £140,000. There was nothing wicked about the process, but it was extremely shortsighted, If the company had retained the monopoly which its pioneer work as a cheap caterer for a long time secured it, it might have kept its prosperity unimpaired even by this shortsighted finance. As it was, success attracted several competitors, some of which

were extremely well managed and financed, and although it still does a most useful work for the community, its earning power has suffered considerably. But this is only an extreme example of a system which is reasonable enough if it is not carried too far. The Canadian Pacific Railway, for instance, has for many years adopted a very moderate use of this system, making new issues to its shareholders on terms rather cheaper than it could have obtained by a public issue, but not giving away enough to impair its future seriously in order to make presents to the existing stockholders by this means. By the continued making of small presents to their constituents the directors of the company have obtained the support of a very loyal body of stockholders, who feel that they are being well treated but not pampered. This system of granting a small bonus to existing shareholders on occasions when the company has to issue new capital is one which is quite unobjectionable as long as it is not abused. If, owing to the use of it, the directors are encouraged to finance themselves badly, that is to say, to pay out of new capital for improvements and extensions which a more prudent policy would have financed out of earnings, just because they find that these issues carrying a small bonus makes them popular with the stockholders, then the system is being abused. Otherwise there seems no reason to object to a measure which keeps the shareholders happy and does not do any harm to the concern so long as it is worked in moderation.

Finally, there is a Bonus share or stock which

does not represent accumulation out of vast profits or issues of new shares at a premium, and does not involve a bonus by the sale to existing shareholders at a price below the terms which could be got in the market, but is at first sight pure water, representing merely possibilities, perhapses, and potentialities. This kind of Bonus share is chiefly known on the other side of the Atlantic, and is usually damned with bell, book and candle by purists among English financial critics. We say on this side of the water that every pound of an English well-financed company represents a pound which has actually been spent and put into tangible assets which help the company to earn profits. This boast is by no means true, since nearly all industrial companies come into being with something paid for in the shape of goodwill, which is of enormous importance, but can hardly be called a tangible asset; and even in the case of our railway companies, many millions of original capital went into Parliamentary and legal expenses, which have been, in one sense, dead capital ever since, though without this expenditure the railways could never have got to work. The American system of Common shares, representing what appears to be water, is only a modification of what every company has to do, in one form or another, on this side or anywhere in the world. Wherever an existing business is bought out something has to be given over and above the old iron value of the concern for the value of the connection and other intangible assets. Wherever an entirely new industry is started it has to meet certain initial

expenses. It has to placate, to use the unpleasant American word, various interests in order to get to work, or it has to lay out money in building up a concern by advertising or otherwise. It is impossible that every penny which is put into it will go into actual buildings, plant, machinery, and stock-in-trade.

In America the system has been preferred by which the actual tangible assets of a new concern are financed wholly or largely by issues of bonds or Preferred stock, and the Common stock is given away to those interested in the promotion, for them either to hold or to use in order to secure the co-operation of those who may be useful, or modify the opposition of those who may be dangerous. The net result of it is that the Common stock is represented in fact by goodwill or the power to get to work. If the company prospers, then it is the business of those who hold these Common shares to see that assets are accumulated out of profits, to be held against their Common stock, so squeezing the water out of it and making it good. The system thus possesses this very considerable advantage, that those who promote a company are interested in its future welfare, and watch over it and guide it through its subsequent existence, putting energy and good management at its disposal in order that the paper which they hold may be represented, not by water, but by real assets, and so may bring them a tangible reward. It has thus in some ways a great advantage over the English system, by which the company promoter is too often concerned merely in the

immediate success of the promotion. He is, as one of the greatest of them described himself, a mere midwife, who brings the interesting infant into the world, pats its little head, says good-bye to it, and leaves it to take care of itself throughout its troubled existence. By the American system the promoter is not a midwife but a doctor who assists at the birth of the infant, and also watches over its youth and makes every effort to guide its toddling footsteps in such a way that it may grow into lusty manhood. It is not until he has done so that he is enabled, by the sale of the shares which were given to him at the beginning, to realise the full profit which he expected. The profits realised by this method are in many cases enormous. On the other hand, the amount of work that is put in to secure them is infinitely greater than happens in the case of the English midwife promoter; and if the enterprise is a failure, then the promoter goes without his profits.

The system, like everything else, is liable to abuse, if a rascally board of directors, in a hurry to unload their holding of Common stock on an unsuspecting public, makes the position and prospects of the company look better than they are by unscrupulous bookkeeping and extravagant distribution of profits, earned or unearned. These things happen in a world in which the ignorance of the public about money matters is a constant invitation to those who are skilled in them to relieve the public of money which it would probably mis-spend; but, if well and honestly worked, the system is by no means inherently unsound, as some English critics too

often assume, and it has been shown that it carries with it a very great and substantial advantage in the hands of honest people who wish to conduct the business of company promotion on progressive lines.

XII

STATE MONOPOLY IN BANKING

August, 1918

Bank Fusions and the State—Their Effects on the Bank of England—Mr Sidney Webb's Forecast—His Views of the Benefits of a Bank Monopoly—The Contrast between German Experts and British Amateurs—Bankers' Charges as affected by Fusions—The Effects of Monopoly without the Fact—The "Disinterested Management" Fallacy—The Proposal to split Banking Functions—A Picture of the State in Control.

A FEW months ago, writing in this Journal on the subject of banking amalgamations, I referred to one of the objections against them, that they tended towards the creation of monopoly, and so encouraged hope on the part of those who would like to see all forms of industry managed by the State, that the banking business might sooner or later be taken over and worked as a State monopoly. At that time this danger of monopoly seemed to be still fairly remote, but since then the progress of amalgamations has brought it appreciably nearer, and so has vigorously stimulated both the hopes and fears of those who consider that it tends to bring nearer the seizure of banking business by the State. The fear is expressed by Sir Charles Addis, manager of the Hongkong Bank and director of the Bank of England, in the July number of the *Edinburgh Review*, in

a very interesting article on the " Problems of British Banking." Sir Charles observes that :

" It may even be questioned whether the gigantic size they have already attained does not constitute a menace to the predominant position which the Bank of England has hitherto enjoyed as the bankers' bank. How will the Bank of England be able to maintain its supremacy and control the money market, surrounded by banks individually greater and more powerful than itself, especially when the object in view is by raising the rate of interest to prevent an internal or external drain upon our gold reserve ? It is even conceivable that the finance of the State may be threatened, and it is probably for this reason that in Germany the Prussian Minister is said to be considering a State monopoly of banking. Nor can the psychological effect of these great aggrandisements of capital in the hands of a few banks be ignored. They are virtually Government-guaranteed institutions. The insolvency of one of the great banks would involve such widespread disaster that no Government could stand aside. They would be compelled to make use of the national resources in order to guarantee the solvency of private banks. From Government guarantee to Government control is but a step, and but one step more to nationalisation. We are playing into the hands of Mr Sidney Webb and the Socialists."

As it happens, in the July number of the *Contemporary Review,* Mr Sidney Webb was developing the same theme, namely, the inevitability of banking monopoly and the necessity, as he conceives it, of defeating private monopoly for the sake of profit, by State monopoly to be worked, as he hopes, in the public interest. His article is headed by the rather misleading title, " How to Prevent Banking

Monopoly," for, as has been said, Mr Webb very much wants monopoly, says that it cannot be helped, and sees the fulfilment of some of his pet Socialistic dreams in the direction of it by the bureaucrat whom he regards as the heaven-sent saviour of society. His very interesting argument is most easily followed by means of a series of quotations.

"We are, it is said, within a measurable distance of there being—save for unimportant exceptions—only one bank, under one general manager, probably a Scotsman, whose power over the nation's industry would be incalculable. Even in the crisis of the war the matter is receiving the attention of the Government.

"In the opinion of the present writer, the amalgamation of banks in this country, which has been going on continuously for a century, though at varying rates, and is being paralleled in other countries, notably in Germany, and latterly in the Canadian Dominion, is an economically inevitable development at a certain stage of capitalist enterprise, and one which cannot effectively be prevented."

Mr Webb considers that there is no economic limit to this policy of amalgamation, and that the gains it carries with it are obvious. He dilates upon these as follows :—

"It may be worth pointing out :

"(*a*) That apart from the obvious economies in the cost of administration, common to all business on a large scale, there is, in British banking practice, a special advantage in a bank being as extensive and all-pervasive as possible. Where distinct banks co-exist, there can be no assurance that the periodical shifting of business, the perpetual transformations in industrial organisation, the rise and fall of industries, localities or firms, the

changes of fashion and the ebb and flow of demand, and even a relative diminution of reputation may not lead to a shrinking of the deposits and current account balances of any one bank, or even of each bank in turn. Accordingly, every bank has to maintain an uninvested, or, at least, a specially liquid, reserve to meet such a possible withdrawal. The smaller, the more numerous, the more specialised by locality or industry are the competing banks, the larger must be this reserve. On the other hand, if all the deposit and current accounts of the nation were kept at one bank, even if it has innumerable branches, as the experience of the Post Office Savings Bank shows, no such shifting of business would affect it; no mere transfers from firm to firm or from trade to trade would involve any shrinking of its aggregate balances; and it would need only to have in hand, somewhere, sufficient currency to replenish temporarily a local drain on its 'till money.' The nearer the banks can approach to this condition of monopoly, not only the lower will be their percentage of working expenses, but also the greater will be the financial stability, and the smaller the amount that they will need to keep uninvested in order to meet possible withdrawals.

"(*b*) That the process of amalgamation has involved an ever-increasing elimination, from the British banking business, of the typical profit-maker, first as partner in a private bank, then as a director in a Joint Stock bank, representing a large personal holding of shares; and the gradual transfer of practically the whole conduct of the business to what may be called 'disinterested management'—that is to say, management by trained, professional officers serving for salaries, whose remuneration bears no relation to the profit made on each piece of business transacted. The part played in the business by the directors themselves seems to be, with every increase in the magnitude and scope of the concern, steadily diminishing; and these directors, moreover, come to be chosen, more and more, not because of their

large holdings of shares, or because of their ancestral or personal connection with banking, but because of their reputation or influence, commercial, social or political. The result is that, along with the process of amalgamation, there has been going on a transfer of the whole management of banking to the hierarchy of salaried officials; whilst the supreme decisions on financial policy are in the hands, in practice, of a very small group of salaried general managers, only partially in consultation with an equally small group of chairmen of boards of directors, themselves usually drawing not inconsiderable salaries."

It seems to me that Mr Webb exaggerates in rather a dangerous degree the reduction, through amalgamation, of the necessity which obliges a bank to keep a considerable reserve of cash. It is quite true that under normal circumstances cash withdrawn from one bank finds its way in due course to another, and that with regard to these mere "till money" transfers there might be a considerable reduction in the amount of cash required if all the banking of the country were in the hands of one business, so that what was withdrawn from one branch would be paid into another. But this fact would not alter the need which compels a bank to keep considerable reserves in cash in order to provide against the possibility of a run. A State bank, if the public takes it into its head that it prefers to have a larger proportion of currency in its own pocket rather than in its bank, may find itself pulled at for cash just as vigorously as a bank managed by private enterprise. This was shown in August, 1914, when very large sums were withdrawn from the Post Office

Savings Bank during the crisis which then impelled many members of the public to hoard money, or compelled them to take it out of their banks because they did not find that the ordinary system of payment by cheques was working with its usual ease.

Moreover, Mr Webb's point about what he calls disinterested management—that is to say, the management of banks by officers whose remuneration bears no relation to the profit made on each piece of business transacted—is one of the matters in which English banking seems likely at least to be modified. Sir Charles Addis, in the article already referred to, calls attention in a very striking passage to the efficiency of the administration of German and English banks, and makes a comparison between the remuneration given to the banking boards of the two countries. The passage is as follows :—

"Scarcely second in importance to the financial strength of a bank is the efficiency of its administration. The German board of direction is composed, to an extent unknown in England, of men possessed of professional and technical knowledge. No one who has been present at a meeting of German bank directors in Berlin, when some foreign enterprise has been under consideration, can have failed to be impressed by the animation with which it was discussed, and by the expert and comparative knowledge displayed by individual directors of the enterprise itself and of the conditions prevailing in the foreign country in which it was proposed to undertake it. He may have been led to reflect ruefully upon the different reception his project met with in his own country. He will recall the meeting of the London board ; the difficulty of withdrawing its members even temporarily from their country pursuits and their

obvious anxiety to lose no time in returning to them ; most of them old men, many of them long retired from business ; some of them ex-Government officials and the like, who have never been in business ; a few ornamental titled persons ; only one or two here and there who have no train to catch and are willing to discuss the matter in hand with attention, and, it may be, with understanding.

"It would be idle to pretend that a board of this kind constitutes anything like the nexus between industry and finance which obtains in Germany, and which is very much to be desired in this country. It may be that we do not pay our men enough. A London director has to be content with an honorific position, a fee of a few hundred pounds a year, and, it must be added, a very exiguous degree of responsibility. That is not enough to attract men in the prime of life with expert or technical knowledge of industry and finance, who would have to submit to a reduction in the large incomes they are earning by the exercise of their special abilities if they were to accept a seat on the board of a bank. There are two things which a good man, in the business sense of the term, will not do without—pay and responsibility. Give him sufficient of the former, and you may saddle him with as much of the latter as you like. You may not always get good men by offering them good pay, but you will certainly not get them without doing so. Apparently shareholders are content so long as their profits are not reduced by more than nominal directors' fees. At a recent meeting of a bank with deposits of over £200,000,000 the proposal to increase the directors' fees to £1000 a year was met by the rejoinder from one of the shareholders present that he did not know what the directors would do with such a sum.

"They manage these things differently in Germany. In the three banks to which we have already referred, after payment by the Deutsche Bank of 5 per cent. of

the net profits to reserve, and of the ordinary dividend of 6 per cent., and by the Disconto-Gesellschaft and the Dresdner Bank of 4 per cent., the directors receive respectively 7 per cent., 7½ per cent., and 4 per cent. (the Disconto's personally liable partners receive 16 per cent.) out of the remainder. The directors are bound by law to supervise all the details of the bank's business, and to keep themselves well informed as to its general policy and methods of management. They are bound by law to exercise the caution of a careful business man, and are liable to be sued for damages arising out of the crime or negligence of their employees. If cases of this kind are seldom brought to public notice, it is not because they do not occur, but because the directors, as a rule, prefer to pay up for the laches of their employees, as they can well afford to do out of their profits, rather than be haled before the Court."

When Mr Webb comes to the question of the dangers resulting from monopoly, he finds that they lie chiefly in a restriction of facilities, and in raising the price exacted for them, and that in both respects the danger appears to be great. There is, he says, every reason to expect that the banker, as the nearest approach to the "economic man," will take the opportunity of raising his charges either by increasing the frequency and the rate of the commission exacted for the keeping of a small account, or by reducing the rate of interest allowed on balances, or adopting the common London practice of refusing it altogether. "The banker, who is not in business for his health, may be expected, on this side of his enterprise, to pursue the policy of 'charging all that the traffic will bear.' It would probably pay the banker actually to refuse small accounts, and

to penalise the employment of cheques for small sums. This would be a social loss."

With regard to the other side of his business, lending to the borrowers, Mr Webb thinks it need not be assumed that the monopolist banker will actually lend less, because he will seek at all times to employ all the capital or credit that he can safely dispose of, but Mr Webb thinks that he is likely, as the result of being relieved of the fear of competition; to feel free to be more arbitrary in his choice of borrowers, and therefore able to indulge in discrimination against persons or kinds of business that he may dislike; that he will raise his charges generally for all accommodation, again, theoretically to " all that the traffic will bear " ; and, finally, that in times of stress with regard to all applicants, and at all times with regard to any applicant who was " in a tight place," that he will extort as the price of indispensable help a theoretically unlimited ransom.

Such are the effects which Mr Webb fears from the process which has already put the control of the greater part of the banking facilities of England into the hands of five huge banks. He thinks that these things may happen long before it is a question of an absolute monopoly in one hand. A monopoly, he says, may be more or less complete, and the economic effects of monopoly may be produced to a greater or less degree at a point far below a complete monopolisation in a single hand. There is much truth in this contention of his. Amalgamation has now come to such a point that every new one not

only brings absolute monopoly more closely in sight, but increases the ease with which agreements among the huge banks might suffice to produce the effects of monopoly without further amalgamations. Mr Webb goes on to argue that it is impossible to stop by legislative prohibition or restriction the progress towards economic monopoly where such progress is financially advantageous to those concerned, and that the only remedy ultimately by which the community can be protected from the dangers which he sees threatening it is for the community to take the monopoly into its own hands, and so to get rid, not of the monopoly, which, from the standpoint of national organisation, he thinks is advantageous, but of the motives leading to extortion. If, he says, " no shareholders are in control with their perpetual and insatiable desire for profit, there is no inducement to take advantage of the needs or helplessness of the customers by restricting service or raising prices." In this sentence, of course, he begs the whole question between the advantage of private enterprise and of Socialistic organisation. Private enterprise works for profit, and therefore makes as much profit as it can out of its customers. It is, therefore, according to Mr Webb's argument, probable that if private enterprise in banking is able to establish monopoly it will squeeze the public to the point of restricting banking facilities and making them dearer. No one can deny that there is some truth in this contention, but, on the other hand, it may very fairly be argued that modern business has perceived the great advantages of a big turn-over and

small profits on each transaction. The experience of the great insurance companies, and of great catering companies, and of enormous private organisations such as the Imperial Tobacco Company, has shown the enormous advantage of providing cheap facilities to the largest possible number of customers; so that fears of natural restriction of banking facilities, through monopoly, if they cannot be set altogether aside, are not by any means a certain consequence even of the establishment of monopoly in private enterprise.

Still weaker is Mr Webb's assumption that if the interests of the shareholders with "their perpetual and insatiable desire for profit" were eliminated, cheap and plentiful banking facilities would inevitably result from bureaucratic management. The contrary has been shown to be the case in the examples of the Post Office, of the Telephone Service, and the London Water Supply. In the case of the telegraph and the telephones, the Government took over prosperous businesses, and has managed them at a loss. In the matter of the Post Office it is not possible to compare the Government with individual enterprise, but it will generally be admitted that the Telephone Service has by no means been improved since the Government took it over. Mr Webb points out that nationalisation, whether of banks or of other forms of enterprise, does not necessarily mean government under a Minister by a branch of the Civil Service. But it is impossible to ignore the fact that as soon as nationalisation takes place those who are responsible for the management of the enterprise

are practically certain to develop the qualities and idiosyncrasies of civil servants, which are so unlikely to tend to elasticity, rapidity and efficiency in business management.

In fact, Mr Webb practically grants this point by the very interesting development he suggests by which the two chief functions of banking should be differentiated, and one of them should be nationalised and the other should remain in the hands of private enterprise. He develops this truly ingenious suggestion as follows :—

"Just as we have (except for some obsolescent survivals) separated the function of issuing paper money from that of keeping current accounts, so we shall separate the function of keeping current accounts from that of money-lending. The habit of the British banker of combining in one and the same concern (*a*) the essentially routine business of keeping current accounts or receiving deposits ; and (*b*) the much more difficult and hazardous business of lending capital to private traders, is not a necessary characteristic of banking organisation ; and, whilst possibly the most profitable to the profit-seeking banker, this combination may not be the most advantageous from the standpoint of the community.

"It may accordingly be suggested that the business of banking, as understood in this country, is destined to be further divided into two parts, one of which is ripe for immediate nationalisation, and need no longer be carried on for private profit, whilst the other should be the sphere of a number of separate and diversely specialised organisations catering for particular needs. The whole of the deposit and current account side of banking —with its services in the way of keeping securities, collecting dividends, meeting calls, making regular

payments, and carrying through the purchase and sale of securities—ought to be united with the Post Office and Trustee Savings Banks and the money order and other postal remittance business, and run as a national service for the receipt and custody of cash, for the utmost possible development of the cheque system, and for the cheapest possible organisation of remittances. There is no longer any reason why this important branch of social organisation should be abandoned to the profit-maker, should be made the instrument of levying an unnecessarily heavy toll on the customers for the benefit of shareholders, and should now be exposed to the imminent danger of monopoly.

"If the receipt and custody of deposits and the keeping of current accounts were made a public service the Government might invest the funds thus placed at its disposal in a variety of ways. A certain proportion, perhaps corresponding to what is now held as savings, would be invested, as at present, in Government securities—not Consols, but such as are repayable at par at fixed dates, including Treasury Bills and Terminable Annuities; and any increase in this amount would, in effect, release so much capital for other uses, by paying off part of the National Debt. But the bulk of the amount, corresponding with the proportion of their resources that the bankers now lend for business purposes, might be advanced, for terms of varying duration, partly to Government Departments and local authorities for all their great and rapidly extending enterprises, formerly abandoned to the profit-maker; and partly to a series of financial concerns, whose business it should be to discount the bills and satisfy the requests for loans of those profit-makers who now appeal to the bankers. But these financial concerns should be organised, it is suggested, very largely by trades and industries, specialising in particular lines, and devoted, so far as possible, to meeting the business needs of the different occupations. Whether they should be financial concerns,

owned and directed by shareholders, and run for their profit; or whether they might not, in some cases, be owned and directed by the great industrial associations and combinations that the Government is now promoting in the various industries, and be run for the advantage of the industries as wholes, may be a matter for consideration and possible experiment. In either case, the concerns to which the Government would lend its capital would, of course, have to be of undoubted financial stability to be secured, it may be, by large uncalled capital, or by the joint and several guarantees of a numerous membership; coupled, possibly, with a charge on the assets."

At first sight this proposal to differentiate the functions of banking is somewhat startling, and one wonders whether it could possibly work. On consideration, however, there seems to be nothing actually impracticable about the scheme. The Government would presumably take over all the offices and branches of the banks of the country, and would therein accept money on deposit and current account, making itself liable to pay the money out on demand or at notice, as the case may be, just as is done by the existing banks; it would hold the necessary cash reserve, and it would apparently itself invest a certain proportion of the money in Government securities, as the banks do at present. The more difficult part of the banking business, the advancing of money to borrowing customers, it would hand over to financial institutions, created for this purpose presumably out of the ashes of the nationalised banking business. These institutions would make themselves responsible for the lending

side of banking, and would obviously, and naturally, be allowed to make a profit on this side of the business. In this differentiation Mr Webb's ingenuity is seen at its very best. He reserves for the State that part of banking which is purely a matter of routine, and he leaves to private enterprise that part of it which requiries the elasticity and judgment and quickness in which the average bureaucrat is most likely to fail. A certain amount of friction may easily arise from this differentiation. The interest that the State would be enabled to allow to depositors would clearly depend to a great extent on the interest which it would be able to receive from the financial institutions engaged in lending the money. These institutions could naturally pay the State interest according to the rate which they were able to charge their borrowing customers, leaving themselves a margin for profit and for protection against the risk that their business would involve. It is obvious that there might at times be considerable difficulty in adjusting these two different points of view, and anybody who knows anything about the length of time and argument involved in inducing officials to make up their minds can only fear that occasional jarring in this connecting link between the two sides of banking might sometimes produce effects which would be awkward for the industry of the country.

But apart from this obvious difficulty, can we contemplate with equanimity the prospect of the State monopoly of the ordinary banking facilities as they present themselves to the man in the street, namely, the provision of bank branches, the use of

the cheque book, the custody of securities and any other articles that the customer wishes to leave with his bank? At present the ease and quickness with which these routine matters of banking are carried out in England are developed to a point which is the envy of foreign visitors. How would it be if every cashier of every bank were converted by the process of nationalisation from the kindly, business-like human being as we know him into the kind of person who ministers to our wants behind the counters of the Post Office? As it is, we go into our bank, to present a cheque in order to provide ourselves with cash for the daily purposes of life; the cashier looks at the signature, recognises the customer, hands him over the money. If that cashier became a Government official how long would it take him to verify the signature, to see whether the customer really had a balance to his credit, and finally furnish him with what he wanted? It is obvious that the change suggested by Mr Webb, though it might work, could only work to the detriment of the convenience of the public, and his hopeful view that the elimination of the profits of the shareholders would mean that these profits would go into the pockets of the community in the form of cheapened facilities for banking customers is an ideal largely based on the assumption, that has so often been proved to be incorrect, that the State can do business as well and as cheaply as private enterprise. It is much more likely that after a few years' time the public would find the business of paying in and getting out its money a very much

more tedious and irritating process than it is at present, and that the expenses of the matter would have grown to such an extent that the taxpayer might be called upon annually to make good a considerable loss.

XIII

FOREIGN CAPITAL

September, 1918

The Difference between Aims and Acts—Should Foreign Capital be allowed in British Industry ?—The Supremacy of London and National Trade—No Need to fear German Capital—We shall need all we can get—Foreign Shares in British Companies—Can and should the Disclosure of Foreign Ownership be forced ?—The Difficulties of the Problem—Aliens and British Shipping—The Position of "Key" Industries—Freedom to Import and Export Capital our Best Policy.

MANY things that are now happening must be tickling the sardonic humour of the Muse of History. The majority of the civilised Powers are banded together to overthrow a menace to civilisation, carrying on a war which, it is hoped, is to produce a state of things in which mankind, purged of the evil spirits of militarism and aggression, is to start on a new order of co-operation. At the same time, while we are engaged in fighting under banners with these noble ideals inscribed on them, a large number of citizens of this country are airing proposals aimed at restrictions upon our intercourse with other nations, especially in the economic sphere. In last month's issue of this Journal a very interesting article, signed "Veritas," discussed the question as to how far it was in the power of the Allies to make use of the

economic weapon against their enemies after the war. That such a question should even be mooted as an end to a war undertaken with these objects, shows what a number of queer cross-currents are at work in the minds of many of us to-day. But some people go much further than that, and are advocating policies by which we should even restrict our commercial and economic intercourse with our brothers-in-arms. If the clamour for Imperial preference is to have any practical result, it can only tend to cultivate trade within the British Empire, protected by an economic ring-fence at the expense of the trade which, before the war, we carried on with our present Allies. And a large number of people who, under the cover of Imperial preference, are agitating also for Protection for this country, would endeavour to make the British Isles as far as possible self-sufficient at the expense of their trade, not only with all their present Allies, but even with their brethren overseas.

It is fortunately probable that the very muddle-headed reasoning which is producing such curious results as these, at a time when the world is preparing to enter on a period of closer co-operation and improved and extended relations between one country and another, is confined, in fact, to a few noisy people who possess in a high degree the faculty of successful self-advertisement. I do not believe that the country as a whole is prepared to relinquish the economic policy which gave it such an enormous increase in material resources during the past century, and has enabled it to stand forward as the industrial and financial champion of the Allied

cause during the difficult early years of the war. Our rulers seem to be sitting very carefully on the top of the fence, waiting to see which way the cat is going to jump. They have made brave statements about abrogating all treaties involving the most-favoured nation clause and about adopting the principle of Imperial preference; but when their eager followers press them to do something besides talking about what they are going to do, they then have a tendency to return to the domain of commonsense and to point out that it is above all desirable that our economic policy should be in unison with that of the United States.

Whatever may happen in the realm of trade and commercial policy, it would seem to be self-evident that with regard to capital it would be still more difficult and undesirable to impose restrictions than with regard to the entry of goods; and above all, it seems to be obvious that at any rate the free entry of capital into this country is a matter which should be specially encouraged when the war is over. At that difficult period we have to secure, if possible, that British industry shall be entirely unhampered in its endeavours to carry out the very puzzling operations involved by transferring its energies from war activities to peace production. However well the thing may be managed, it will be an exceedingly difficult and complicated operation. In certain industries, especially in shipbuilding and engineering, the building trade and all the allied enterprises, those who are responsible for their efficient management ought to be able to count upon a keen and

widely-spread demand for their products. But in many industries there will necessarily be a good deal of doubt as to the kind of article which the consuming public at home and abroad is likely to want. There will be the great difficulty of sorting out the right kind of labour, of obtaining the necessary raw materials, and of getting the necessary credit and capital.

That this huge problem can be solved, and solved so well that the country can go ahead to a great period of increased productivity and prosperity, I fully believe; but this can only be done if it is able to command the most efficient co-operation of all the various factors in production—if employers put their best brains and if workers put their best energy into the business, and if everything is done to make the whole machinery work with the utmost possible smoothness. One element in the machinery, and a highly important one, is the question of capital. During the war the citizens of this country have been trained to save and to put their money at the disposal of the Government with a success which could hardly have been expected when the war began. Whether they will continue to exercise the same self-denial when the war is over is a very open question. At any rate, there can be no doubt that there will be a tendency among a very large number of people who have answered the appeal to save money for the war to listen with considerable indifference to any appeals that may be made to them to save money in order to provide industry with capital. All the capital that industry can get,

it will certainly want. If, besides what it can get at home, it can also get a considerable amount from foreign countries, then its ability to resume work on a prosperous and profitable basis when the war is over will be very greatly helped. This would seem to be so obvious that one might have thought that even a Government which is believed to be flirting with what is called Tariff Reform would think twice before it imposed any restrictions on the free flow of foreign capital into British industry. In so far as foreigners lend to us we shall be able to import raw materials, to be worked up to the profit of British industry, in return for promises to pay—a very timely convenience at a critical moment.

Nevertheless, it would appear that obviousness of the desirability of foreign capital, from whatever source it comes, is by no means evident to those who are now in charge of the nation's destinies. At any rate, the Company Law Amendment Committee, which was appointed last February "to inquire what amendments are expedient in the Companies Acts, 1908 to 1917, particularly having regard to circumstances arising out of the war and of the developments likely to arise on its conclusion," seems to have thought it necessary to provide the Government with schemes by which alien capital could, if the Government thought necessary, be kept out of the country. It was a powerful and representative Committee, and it is very satisfactory to note that its own view concerning the policy to be pursued was strongly in favour of freedom. It points out in its Report that the question which

lay in the forefront of its investigations was that of the employment of foreign capital in British industries. On the preliminary question of whether it was desirable that foreign capital should be freely attracted to this country, there was little, if any, difference of opinion. For this very sensible conclusion the Committee gives rather a curious reason. It states that the maintenance of London as the financial centre of the world is of the first importance for the well-being of the Empire, and that anything which could impede or restrict the free flow of capital to the United Kingdom would, in itself, be prejudicial to Imperial interests.

Now, of course, it is entirely true that the maintenance of London as a financial centre is very important, but I venture to think that those who are most jealous concerning the prestige of London and the importance of its financial operations would say that it ranks only second to the industrial efficiency of the country as a whole and cannot, in fact, be long maintained unless there is that industrial efficiency behind it, providing a surplus out of which London may be able to finance the world and so, incidentally, and as a side issue, be to a great extent helped by foreign capital to do so. It is surely evident that a financial supremacy which was based merely on a jobbing business, gathering in capital from one nation and lending it to another, would be an extremely precarious and artificial structure, the continuance of which could not be relied on for many decades. Finance can only flourish healthily and wholesomely in a country

which produces a considerable surplus of goods and services which it is prepared to place at the disposal of the world. Owing to the possession of this surplus it becomes a market in capital, and so gets a considerable jobbing business, but the backbone and foundation of its position must be, in the end, industrial activity in the widest sense of the word. It therefore seems that the Committee's argument that the free flow of capital is essential to the maintenance of London's finance might have been reinforced by the very much stronger one that it is essential to the recuperative power of British industry, which will need every assistance it can get in order to re-establish itself after the war.

The Committee points out that " any legislation which would tend to impede or restrict the free flow of capital here by imposing restrictions or creating impediments ought to be jealously watched, lest in the endeavour to prevent what has come to be called ' peaceful penetration ' the normal course of commercial development should be arrested," and it goes on to observe that at the end of the war, " if it should be concluded upon such terms as we hope and anticipate," it is not likely that our present enemies will be in possession of capital looking for employment abroad. This is certainly very true. By the time the Germans have made the reparations, which will involve so much rebuilding in Belgium and in the parts of France that they have overrun and swept clean of industrial plant, and have in other respects made good the damage which their ruthless and uncivilised methods of warfare have inflicted, not

only on their enemies, but on neutrals, it does not seem likely that they will have much to spare for capital expansion in foreign countries, especially when we consider how many problems of reconstruction they will themselves have to face at home. "To impose restrictions upon the influx of capital," the Report continues, "aimed at our present enemies, with the result of deterring the flow of capital from (say) America, would be a policy highly injurious to the economic recovery and renewed prosperity of this country after the war. For these reasons we are of opinion that in all amendments of the law falling within the scope of our reference, the expediency of the attraction of foreign capital should be steadily borne in mind." The Committee thus seems to have thought it necessary to administer comfort to anybody who might fear that the unrestricted flow of capital from abroad might involve this country in the terrible danger of being assisted in its industrial recovery by capital from Germany.

If there were, in fact, any possibility of this assistance being given, it would seem to be extremely short-sighted not to allow British industry to make use of it. In the matter of "peaceful penetration," we have ourselves in the past done perhaps as much as all the rest of the countries of the world put together, with the result that we have greatly stimulated the development of economic prosperity all over the world; in fact, it may be argued that the great progress made in the last century in man's power over the forces of Nature has been to a great extent due to the freedom with which we invested

capital abroad and opened a free market to the products of all other countries. At a time when, owing to exceptional circumstances, we ourselves happen to be in need of capital, it would appear to be an extremely short-sighted policy to refuse to admit it, wherever it came from. We have excellent reason to known that, when capital is once invested in a foreign country, it is largely in the power of the inhabitants and Government of that country to control its working. Any foreigner, even an enemy, who set up a factory in England after the war would be doing just the very thing which we most of all want to be done, namely, setting the wheels of industry going, relieving the labour market from a possible glut after demobilisation, and helping that difficult stage of transition from war work to peace work.

The Committee, however, considers that "at the root of the whole matter lies a question which is not one of Company Law amendment at all, but one of high political and economic policy." It does not fall within its province "to inquire whether the traditional policy of this country to admit and welcome all who seek our shores and submit themselves loyally to our laws ought, in the case of some and what aliens, to be revised"; or whether discrimination ought to be made between an alien of one nationality and an alien of another. "As regards aliens who are now our enemies, it may be that the British Empire may adopt the policy that a special stigma ought to be attached to the German, and that neither as an individual, nor as a firm, nor

as a corporation, ought he, for a time at any rate, to be admitted to commercial fellowship or to any fellowship with the civilised nations of the world." It need not be said that any attempt to apply this stigma in practice would be extremely difficult to carry out, would involve all kinds of difficulties and complications in trade and in finance, and that the threat of it is more likely than anything else to stiffen the resistance of the Germans and to force them to rely on their militarist leaders as their only hope of salvation. However, the Committee points out that recent legislation shows a desire to ascertain and record the extent to which aliens are active in commerce here, and thinks it necessary to make provision to meet the requirements of the Government in case our rulers should decide to impose the restrictions which its own common-sense shows it are so undesirable.

If, it says, foreign capital is to be attracted here, it must be represented either by shares or by debentures. "The question, therefore, is whether restrictions ought to be imposed upon the extent to which the control of the company shall be allowed to reside in aliens, either by reason of their holding a majority of the shares, or of the debentures, or by reason of their obtaining a majority upon the Board of Directors; and, if so, how disclosure of their alien character is to be enforced." It goes on to point out the great difficulties which present themselves in the way of securing disclosure of nationality and ensuring that aliens shall not command the control. "The law of trusts," it says, "is firmly established in this

country. If A. be the registered holder of a share, he is not necessarily the beneficial owner. He may be a trustee for B. To enact that the registered holder must be a British subject effects nothing, for B. may be an alien and an enemy. Suppose, however, that you enact that A., when his share is allotted or transferred to him, shall make a declaration that he holds in his own right, or that he holds in trust for B., and that both A. and B. are British subjects. There is nothing to prevent the creation of a new trust the next day, under which C., an alien enemy, will be the person beneficially entitled. Further, at the earlier date (the date of allotment or transfer) the facts may be that A. (a British subject) is trustee for B. (a British subject), but that B. (unknown to A.) is a trustee for C., an alien enemy. The fact that B. is trustee for C. would be purposely withheld from A., and A.'s declaration that he was simply trustee for B. would be perfectly true. To require that A. should make a declaration at short intervals (say once a month), or that A., B., C., and so on, should all make declarations would be, of course, so harassing and so detrimental as to be, as a matter of business, impossible. The only effectual way of dealing with the matter would be by a provision that the share might be forfeited, or might be sold and the proceeds paid to the owner, if an alien should be, or become beneficially entitled to or interested in the share. Such a provision does not in the general case commend itself to us as practical or desirable." Any endeavour to control the nationality of the Board of Directors produces

similar difficulties. It is easy to ensure that they shall be all, or a majority of them, British subjects, but there is no means of ensuring that their actions shall not be controlled by aliens whose nationality is not disclosed.

Having pointed out these difficulties, which seem in effect to reduce the whole question to the domain of farce, the Committee goes on to inquire whether it is desirable to legislate in the direction of forbidding the employment of foreign capital here in Joint Stock Companies, unless :—

(1) There is disclosure of the alien character of the foreign owner ;

(2) Not more than a certain proportion of the Company's shares are held by aliens ;

(3) The Board, or a certain proportion of the Board, shall not be alien ;

and, further, whether it is desirable to discriminate between one alien and another, and to legislate in that direction in the case of certain aliens and not of others.

In answering these questions, the Committee decided that it was necessary to discriminate between certain classes of companies—Class A being companies in general, Class B. being companies owning British shipping, and Class C companies engaged in "key" industries. With regard to companies in Class A, they recommend that no restrictions at all be imposed, but, nevertheless, they elaborate a scheme of enforcing disclosure of alien ownership if that policy seems to the legislature to be right. This scheme, the Committee admits, is necessarily detailed

and laborious; it puts difficulties in the way of investment in English securities, whether by British subject or alien. It would supply, no doubt, to the Board of Trade useful information as to the extent of foreign investment in English industries, but the price paid for this advantage would, in the Committee's opinion, be too great. If adopted, the scheme could be evaded. And, with regard to companies in general, the Committee's recommendations go the length of allowing complete freedom as to the nationality both of the corporators and of the Board. They would allow, for instance, American capitalists to come here and establish themselves as a British corporation in which all the corporators and all the directors were American, and so with every other nationality. They would make no discrimination between aliens of different nationality, for, if there is to be such discrimination, there must be the machinery of disclosure, involving a deterrent effect and acting prejudicially in the case of all investors. But, if any such discrimination were adopted, the Committee thinks that at any rate it should be limited to some short period, say, three or five years after the end of the war.

If, however, the legislature should decide upon the necessity of disclosure of alien ownership, the Committee draws up the following scheme for securing it in Paragraph 15 of its Report:

15. For reasons already given, it is not possible efficiently to ensure full disclosure, but the following suggestions would, in the absence of deliberate and intentional evasion (which would be quite possible), meet

the point and in the large majority of cases would disclose the extent of alien interests and control :—

(*a*) Every allottee of shares upon allotment and every transferee upon transfer should be required to make a declaration disclosing his nationality and whether he is the beneficial owner of the shares, and, if not, for whom he is trustee, and what is the nationality of the beneficial owner, and should undertake within a limited time, after any change in the beneficial ownership, to communicate the new facts to the company. In default of compliance with the above, the shares should, at the option of the company, either (1) be liable to sale by the company and the holder be entitled only to the proceeds ; or (2) be liable to forfeiture and the holder be entitled to receive payment from the company of 10 per cent. less than the market value of the share, or if there be no market value, then 10 per cent. less than the value at which the share would be taken for *ad valorem* stamp duty if it were the subject of transfer. In case the company made default in exercising its power, the Board of Trade should be authorised to require the above sale to be made.

(*b*) Every director, upon coming into office, should be required to make a declaration disclosing his nationality and stating whether in his office he is wholly free from the control or influence of any alien, and if he is not so free, stating by whose directions or under whose control or influence he is to act and what is the nationality of that person, and should undertake within a limited time after any change in that state of things to communicate the facts to the Board and procure a statement of the facts to be entered in the Board minutes. Any breach of these obligations to be visited with a penalty which should be severe.

(*c*) The company should be required to enter in the register of members, against the name of every registered member, his nationality as disclosed by the declaration. In the case where the registered member is not the beneficial owner, the company should be required to record, not in the register, but in another book, the nationality of the beneficial owner as disclosed by the declaration, and, as regards the latter book, to record the nationality of any new beneficial owner when and as disclosed by the registered member. These particulars should be required to be included in the annual list under Section 26 of the Act of 1908. That list would thus become not a list of members only, but a list of members with the addition of beneficial owners. The company should, further, be required to add to the annual list a summary of the result as regards nationality showing (1) as regards registered members, how many are British subjects and how many shares they hold, and how many are aliens and how many shares they hold, subdividing the number of the aliens and their holdings under their respective nationalities; and (2) as regards the registered members who are British subjects: (*a*) how many of them are the beneficial owners and how many shares they hold, and (*b*) as regards the rest, what are the nationalities and holdings of the beneficial owners.

With regard to companies owning British shipping, the Committee is satisfied that the total exclusion of aliens from ownership of British ships is not essential for national safety and is not expedient. It therefore considers that in these companies it will be sufficient to ensure that not more

than 20 per cent. of the power of control should be in alien hands. It thinks that there should be this limit of 20 per cent., that not more than 20 per cent. of the share capital should be held by aliens, and that those shares should carry no more than 20 per cent. of the voting power. Alternatively, it considers that the alien holdings should carry no vote at all, but that is a point of detail deserving further consideration. It follows that in this class there must, in the opinion of the Committee, be disclosure of nationality, which should be enforced in the manner detailed above, which, on its own admission, is not proof against deliberate evasion.

With regard to companies carrying on "key" industries, a very complicated system is recommended. In the first place, the question whether a company is one to carry on a "key" industry would seldom or never arise at the time of its registration. The modern Memorandum of Association includes so many things that a "key" industry might be within the powers of almost any company. The question would thus arise when the company has got to work. And so the Committee thinks that the Board of Trade should be empowered at any time to make an inquiry whether any company is carrying on a "key" industry and, if it finds that it is, then the company shall, at the direction of the Board of Trade, require every registered member to make a declaration such as, under the disclosure procedure already described, he would have had to make if he were at the date of the notice about to receive an allotment or become a transferee. Further, the holders of share warrants

to bearer would be required to surrender their warrants for cancellation and have their names entered in the register, and all subsequent allottees and transferees would be subject to the obligation of disclosure, as already described, and the limits of 20 per cent. recommended in the case of merchant shipping would then be made applicable. Under the system of disclosure it follows that bearer shares are impossible, but, if disclosure be negatived, the opinion of the Committee is in favour of the maintenance of the bearer share.

It should be mentioned that one member of the Committee produced a reservation strongly combating even the very moderate views expressed by the Committee on the subject of British shipping and "key" industries. It should be noted, however, that he attended very few meetings of the Committee. He points out that, with regard to the registration of ships as British when they are owned by a company which has alien shareholders, "it is not usually a question of permitting a ship which would in any case be British to be under the control of aliens; the question is whether, if a number of persons, some or all of whom are aliens, own a ship, they should be permitted to register it as a British ship by forming themselves into a British company and establishing an office in the British Dominions. If," he observes, "they were not allowed to do so they would still own the ship, but register it as a foreign ship in some other country. It appears that a number of ships were registered here before the war by companies with alien shareholders (some even

with enemy shareholders). They were managed in this country; the profits earned by them were subject to our taxation; they were obliged to conform to the regulations of our Merchant Shipping Acts; they carried officers and men who were members of the Royal Naval Reserve; on the outbreak of war our Government was able to requisition the ships owing to their British registration and without regard to the nationality of the shareholders in the companies owning them." It appears to this recalcitrant member—and there is much to be said for his view—that all these consequences have been highly advantageous to this country. On the subject of "key" industries he is equally unconvinced. It appears to him that "the important thing is to get the industries established in this country, and that the question of their ownership is of secondary consequence."

It is very satisfactory to note, in view of wild talk that has lately been current with regard to restrictions on our power to export capital, that the Committee has not a word to say for any continuance, after the war, of the supervision now exercised over new issues. The restrictions which it did recommend, while admitting their futility, on imports of capital into our shipping and "key" industries were evidently based on fears of possible war in future. The moral is that this war has to be brought to such an end that war and its barbarisms shall be "spurlos versenkt," and that humanity shall be able to go about its business unimpeded by all the stupid bothers and complications that arise from its possibility.

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XIV

NATIONAL GUILDS

October, 1918

The Present Economic Structure—Its Weaknesses and Injustices—Were things ever better ?—The Aim of State Socialism—A Rival Theory—The New Movement of Guild Socialism—Its Doctrines and Assumptions—Payment "as Human Beings"—The "Degradation" of earning Wages—Production irrespective of Demand—Is that the Real Meaning of Freedom ?—The Old Evils under a New Name—A Conceivably Practical Scheme for some other World.

Most people will admit that there are many glaring faults in the present economic structure of society. Wealth has been increased at an exhilarating pace during the last century, and yet the war has shown us that we had not nearly realised how great is the productive power of a nation when it is in earnest, and that the pace at which wealth has been multiplied may, if we make the right use of our plant and experience, be very greatly quickened in the next. The great increase in wealth that has taken place has been certainly accompanied by some improvement in its distribution ; but it must be admitted that in this respect we are very far from satisfactory results, and that a system which produces bloated luxury plus extreme boredom at one end of the scale and destitution and despair at the other, can hardly be called the last word, or even the first, in civilisation,

The career has been opened, more or less, to talent. But the handicap is so uneven and capricious that only exceptional talent or exceptional luck can fight its way from the bottom to the top, the process by which it does so is not always altogether edifying, and the result, when the thing has been done, is not always entirely satisfactory either to the victorious individual or to the community at whose expense he has won his spoils. The prize of victory is wealth and buying power, and the means to victory is, in the main, providing an ignorant and gullible public with some article or service that it wants or can be persuaded to believe that it wants. The kind of person that is most successful in winning this kind of victory is not always one who is likely to make the best possible use of the enormous power that wealth now puts into the hands of its owner.

Those who are fond of amusing themselves by looking back, through rose-coloured spectacles, at more or less imaginary pictures of the good old mediæval times, can make out a fair case for the argument that in those days the spoils were won by a better kind of conqueror, who was likely to make a better use of his victory. In times when man was chiefly a predatory animal and the way to success in life was by military prowess, readiness in attack and a downright stroke in defence, it is easy to fancy that the folk who came to the top of the world, or maintained a position there, were necessarily possessed of courage and bodily vigour and of all the rough virtues associated with the ideal of chivalry. Perhaps it was so in some cases, and there is certainly

something more romantic about the career of a man who fought his way to success than about that of the fortunate speculator in production or trade, to say nothing of the lucky gambler who can in these times found a fortune on market tips in the Kaffir circus or the industrial "penny bazaar." Nevertheless, it is likely enough that even in the best of the mediæval days success was not only to the strong and brave, but also went often to the cunning, fawning schemer who pulled the brawny leg of the burly fighting-man. However that may be, there can be no doubt that now the prizes of fortune often go to those who cannot be trusted to make good use of them or even to enjoy them, that Mr Wells's great satire on our financial upstarts—"Tono-Bungay"—has plenty of truth in it, and that our present system, by its shocking waste of millions of good brains that never get a chance of development, is an economic blunder as well as an injustice that calls for remedy.

This being so, it is the business of all who want to see things made better to examine with most respectful attention any schemes that are put forward for the reconstruction of society, however strongly we may feel that real improvement is only to be got, not by reconstructing society but by improving the bodily and mental health and efficiency of its members. The advocates of Socialism have had a patient and interested hearing for many decades, except among those to whom anything new is necessarily anathema. There was something attractive in the notion that if all men worked for the good of the community and not for their own individual

profit, the work of the world might be done much better, because all the waste of competition and advertisement would be cut out, machinery would be given its full chance because it would be making work easier instead of causing unemployment, and a greater output, more evenly distributed, would enable the nation to breed a race, each generation of which would come nearer to perfection. So splendid if true ; but one always felt misgivings as to whether the general standard of work might not deteriorate instead of improve if the stimulus of individual gain were withdrawn ; and that the net result might probably be a diminished output consumed by a discontented people, less happy under a possibly stupid and short-sighted bureaucracy, than it is now when the chances of life at least give it the glorious uncertainty of cricket. Since the war our experiences of official control, even when working on a nation trained in individual initiative, have increased those misgivings manifold ; and hundreds of people who were Socialistically inclined in 1914 will now say that any system which handed over the regulation of production and distribution to the State could end only in disaster, unless we could first build up a new machinery of State and a new people for it to work on.

Partly, perhaps, owing to this discredit into which the doctrines of State Socialism have lately fallen, increasing attention has been given to a body of theory that was already active before the war and advocates a system of what it calls Guild Socialism, under which industry is to be worked by National

Guilds, embracing all the workers, both by brain and by hand, in the various kinds of production. Its advocates are, as far as I have been able to study their pronouncements, decidedly hostile to State Socialism and needlessly rude to some of its most prominent preachers, such as Mr and Mrs Webb, who at least merit the respect due to those who have given lives of work to supporting a cause which they believe to be sound and in the best interests of mankind. But in spite of their chronic and sometimes ill-mannered facetiousness at the expense of State Socialism and its advocates, the Guild Socialists, as we shall see, have to rely on State control for very important wheels in their machinery and leave gaps in it which, as far as disinterested observers can see, can only be filled by still further help from the discredited State. It is no disparagement of the efforts of these writers and thinkers to say that their sketch of the system that they hope to see built up is somewhat hazy. That is inevitable. They are groping towards a new social and economic order which, in their hope and belief, would be an improvement. To expect them to work it out in every detail would be to ask them to commit an absurdity. The thing would have to grow as it developed, and we can only ask them to show us a main outline. This has been done in many publications, among which I have studied, with as much care as these distracting times allow, " Self-Government in Industry," by G. D. H. Cole, " National Guilds," by A. R. Orage (so described on the back of the book, but the title-page says that it is by

S. G. Hobson, edited by A. R. Orage), and "The Meaning of National Guilds," by C. E. Bechhofer and M. B. Reckitt.

These authorities seem to agree in thinking (1) that the capitalist is a thief, (2) that the manual worker is a wage slave, (3) that freedom (in the sense of being able to work as he likes) is every man's rightful birthright, and (4) that this freedom is to be achieved through the establishment of National Guilds. As to (1) Messrs Bechhofer and Reckitt speak on page 99 of their book of the "felony of Capitalism" as a matter that need not be argued about. Mr Cole makes the same assumption by observing on page 235 of the work already mentioned that "to do good work for a capitalist employer is merely, if we view the situation rationally, to help a thief to steal more successfully." Well, this view of capital and the capitalist may be true. Mr Cole is a highly educated and gifted gentleman, and a Fellow of Magdalen. He may have expounded and proved this point in some work that I have not been fortunate enough to read. But as the abolition of the capitalist is one of the chief aims put forward by these writers it seems a pity that they should thus first assert that he is a thief to be stamped out, instead of explaining the matter to old-fashioned folk who believe that capitalists are, in the main, the people (or representatives of the people) who have equipped industry, and enormously multiplied its efficiency and output, and so have enabled the greater part of the existing population of this country (and most others) to come into being.

But to the Guild Socialists the identity of robbery with capitalism seems to be so self-evident that it needs no proof. Next, as to the wage system. They seem to think that to earn a wage is slavery and degradation, but to receive pay is freedom. With the best will in the world I have tried to see where this immense difference between the use of two words, which seem to me to mean much the same thing, comes in in their view, but I have not succeeded. Perhaps you will be able to if I give you Mr Cole's own words.

On page 154 of the book cited, he says that the wage system is " the root of the whole tyranny of capitalism," and then continues :

" There are four distinguishing marks of the wage system upon which National Guildsmen are accustomed to fix their attention. Let me set them out clearly in the simplest terms.

" 1. The wage system abstracts ' labour ' from the labourer, so that the one can be bought and sold apart from the other.

" 2. Consequently, wages are paid to the wage worker only when it is profitable to the capitalist to employ his labour.

" 3. The wage worker, in return for his wage, surrenders all control over the organisation of production.

" 4. The wage worker, in return for his wage, surrenders all claim upon the product of his labour.

" If the wage system is to be abolished, all these four marks of degraded status must be removed.

National Guilds, then, must assure to the worker, at least, the following things :—

" 1. Recognition and payment as a human being, and not merely as a mortal tenement of so much labour power for which an efficient demand exists.

" 2. Consequently, payment in employment and in unemployment, in sickness and in health alike.

" 3. Control of the organisation of production in co-operation with his fellows.

" 4. A claim upon the product of his work, also exercised in co-operation with his fellows."

Now, looking with a most dispassionate eye and an eager desire to find out what it is that Labour and its spokesmen are grouping after, can one find in these " marks of degraded status " any serious evil, or anything that is capable of remedy under any conceivable economic system ? In all of them the wage-earner is on exactly the same footing as the salary-earner or the professional piece-worker. The labour of the manager of the works can also be abstracted from the manager, and can be bought and sold apart from him. One would have thought that this fact is rather in favour of the manager and of the wage-earner—or would Mr Cole prefer that the latter should be bought and sold himself ? The salary-earner and the professional are only employed when somebody wants them. The manager's term of employment is longer, but the professional piece-worker, such as I am when I write this article, has usually no contracted term, and is only paid for actual

work done. I also have no control over the organisation of the production of *Sperling's Journal* or any other paper for which I do piecework. I am very glad that it is so, for organising production is a very difficult and complicated and risky business, and from all the risks of it the wage-earner is saved. The salary-earner or the professional, when once his product is turned out and paid for, also surrenders all claim upon the product. What else could any reasonable wage-earner or professional expect or desire? The brickmaker or the doctor cannot, after being paid for making bricks or mending a broken leg, expect still to have the bricks or the leg for his very own. And how much use would they be to him if he could? Unless he were to be allowed to sell them again to somebody else, which, after being once paid for them, would merely be absurd.

But when we come to the remedies that Mr Cole suggests for these "marks of degraded status," we find in the forefront of them that the worker must be secured "payment as a human being, and not merely as a mortal tenement of so much labour power for which an efficient demand exists." This, especially to an incurably lazy person like myself, is an extremely attractive programme. To be paid, and paid well, merely in return for having "taken the trouble to be born," is an ideal towards which my happiest dreams have ever struggled in vain. But would it work as a practical scheme? Speaking for myself, I can guarantee that under such circumstances I should potter about with many activities

that would amuse my delicious leisure, but I doubt whether any of them would be regarded by society as a fit return for the pleasant livelihood that it gave me. And human society can only be supplied with the things that it needs if its members turn out, not what it amuses them to make or produce, but what other people want. And it is here that the National Guildsmen's idea of freedom seems, in my humble judgment, to be entirely unsocial. As things are, nobody can make money unless he produces what somebody wants and will pay for. Even the capitalist, if he puts his capital into producing an article for which there is no demand, will get no return on it. In other words, we can only earn economic freedom by doing something that our fellows want us to do, and so co-operating in the work of supplying man's need. (That many of man's needs are stupid and vulgar is most true, but the only way to cure that is to teach him to want something better.) The Guildsmen seem to think that this necessity to make or do something that is wanted implies slavery, and ought to be abolished. They are fond of quoting Rousseau's remark that "man is born free and is everywhere in chains." But is man born free to work as and on what he likes? In a state of Nature man is born—in most climates—under the sternest necessity to work hard to catch or grow his food, to make himself clothes and build himself shelter. And if he ignores this necessity the penalty is death. The notion that man is born with a "right to live" is totally belied by the facts of natural existence. It is encouraged by humanitarian

sentiment which rightly makes society responsible for the subsistence of all those born under its wing; but it is not part of the scheme of the universe.

Such are a few of the weaknesses involved by the theoretical basis on which Guild Socialism is built. When we come to its practical application we find the creed still more unsatisfactory. Even if we grant—an enormous and quite unjustified assumption—that the Guildsman, if he is to be paid merely for being alive, will work hard enough to pay the community for paying him, we have then to ask how and whether he will achieve greater freedom under the Guilds than he has now. Now, freedom is only to be got by work of a kind that somebody wants, and wants enough to pay for it. And so the consumer ultimately decides what work shall be done. The Guildsman says that the producer ought to decide what he shall produce and what is to be done with it when he has produced it. "Under Guild Socialism," says Mr Cole,* "as under Syndicalism, the State stands apart from production, and the worker is placed in control." Very well, but what one wants to know is what will happen if the Guilds choose to produce things that nobody wants. Will they and their members be paid all the same? Presumably, since they are to be paid "as human beings" and not because there is a demand for their work. But if so, what will happen to the Guildsman as consumer? There will be no freedom about his choice of things that he would like to enjoy. And

* "The Meaning of Industrial Freedom," page 39.

what about admission to membership of a Guild, the price at which the Guilds will exchange products one with another, and the provision of capital? The nearest approach to an answer to these questions is given by Messrs Bechhofer and Reckitt in Chapter VIII. of the "Meaning of National Guilds." This chapter describes "National Guilds in Being." It tells us that "each man will be free to choose his Guild," which sounds very pleasant, but is completely spoilt by the end of the sentence, which says "and actual entrance will depend on the demand for labour." It sounds just like a capitalistic factory. And then—"Labour in dirty industries, sewaging, etc.—will probably be in the main of a temporary character, and will be undertaken by those who are for the time unable to obtain an entry elsewhere." Most sensible, but where is the freedom? The Guildsman will not be able to do the work that he wants to do unless there is a demand for that kind of labour, and in the meantime, just like the unemployed in the days of darkness, he will be set to cleaning the streets and flushing the drains. Messrs Bechhofer and Reckitt are, in fact, so sensible and practical that they abandon altogether the freedom of the producer to produce what he likes. "Indeed," they write, "a query often brought to confound National Guildsmen is this: What would happen to a National Guild that began to work wholly according to its own pleasure without regard to the other Guilds and the rest of the community? We may reply, first, that this spirit would be as unnatural among the Guilds as it is natural nowadays with the present

anti-communal, capitalist system of industry" (but under the present system any one who worked without regard to the rest of the community would very soon be in the hands of a Receiver); "secondly, if it did arise in any Guild, this contempt for the rest of the community would be met by the concerted action of the other Guilds. The dependence of any individual Guild upon the others would be necessarily so great that a recalcitrant Guild would find itself at once in a most difficult position, and a Guild that pressed forward demands that were generally felt by the rest of the community to be impossible or unreasonable would soon be brought back into line again."

Of course; but if so, where is the Guildsman's alleged freedom? Every Guild and every Guildsman would have to adapt himself to the wants of the community, just as all of us who work for our living have to do now. He would be no more free than I am, and I am no more free than the person who is sometimes described as a "wage slave." The Guildsman might be happier in the feeling that he worked for a Guild rather than a capitalist employer, but this is by no means certain. The writers just quoted show with much frankness and good sense that there would be plenty of opening for friction, suspicion, discontent and strikes. "A Guild," they say, "that thought itself ill-used by its fellows would be able to signify its displeasure by the threat of a strike." The officials of the Guild are to be chosen by the "men best qualified to judge" of their ability, whoever they may be, and every such choice would be

ratified by the workers who are to be affected by it. "The Guild would build up in this way a pyramid of officers, each chosen by the grade immediately below that which he is to occupy." Did not the Bolsheviks try something like this system, with results that were not conducive to efficient production? And to meet the danger that the officials as a whole might combine "in a huge conspiracy against the rank and file," Messrs Bechhofer and Reckitt can only suggest vigilance committees within the Guilds. In a word, Guild Socialism seems to be a system that might possibly be worked by a set of ideally perfect beings; but as folk are in this workaday world one can only doubt whether it would be conducive either to freedom, efficiency or a pleasant life for those who lived under it.

XV

POST-WAR FINANCE

November, 1918

Taxation after the War—Mr. Hoare's Scheme described and analysed—The Position of the Rentier—Estimates of the Post-War Debt—The Compulsory Loan Proposal—What Advantages has it over a Levy on Capital ?—The Argument from Social Justice—Questions still to be answered—The Choice between a Levy and Stiff Taxation—Are we still a Creditor Nation ?—Our Debt not a Hopeless Problem—Suggestions for solving it.

UNDER this heading two very interesting articles were contributed to the October issue of *Sperling's Journal* by Mr Alfred Hoare and an "Ex-M.P.," and the subject is clearly one to which, now that the end of the war has been brought appreciably nearer by the feats of the Allied armies, too much thought and discussion can hardly be given. How are we going to face the problem that has been built up for us by the bad finance of the war, the low proportion of its cost that has been paid for out of taxation, and the consequent huge debt with which—it is already over £7000 millions gross—the State will be saddled ? Mr. Hoare answered the question by proposing a scheme of taxation of what he called Rente, by which he meant all forms of "unearned income" —"rentals from freehold and leasehold property,

interest upon loans whether public or private, and dividends on joint stock companies or sleeping partnerships." He added that in his opinion earned income above a certain figure might reasonably be added to this category on the ground that it has, in some instances, very much the same characteristics as unearned; the income of a "successful professional man or clown or jockey or opera star" being due to peculiar qualities; "and it would be no great hardship if earned income above, say, a thousand a year for a married couple, with an additional three hundred for every child under twenty-five years of age were regarded as unearned, and taxed accordingly." Income was thus the basis of Mr Hoare's scheme. Rente he regards as an agency regulating distribution, and requiring to be constantly checked. "It is," he says, "an elementary principle of social health and economic prosperity that the share of the national wealth enjoyed by the Rentier, by the owner, that is, of unearned income, should not be excessive." Most people who can follow his admirable example and take a detached and unbiassed view of questions which affect their pocket so closely, will agree with him in this opinion. The Rentier lives on the proceeds of work done in the past by him or by some other person; and it is not good for our economic health that he should grow too fat at the expense of those who are working now, lest the latter be discouraged and work with less spirit.

At the same time we have to remember that the work done in the past by the Rentier or those whom

he represents, has given us the plant and equipment (in the widest sense of the phrase) with which we are now working. If, therefore, we penalise the Rentier too severely we shall discourage his future creation; the present race of earners, if they see that those who are living on past savings are shorn too close will be deterred from saving, will put their surplus earnings into extravagant spending instead of into plant and equipment, and the economic future of the nation, and of the world, will be *pro tanto* less hopeful. If once our fiscal system is going to propagate the view —already so rampant among the happy-go-lucky citizens of this unthrifty people—that the worst thing to do with money is to save it there will be bad times ahead for our industry and commerce, which can only get the capital that it needs if somebody saves it. Mr Hoare's elaborate calculations led him to conclusions involving a tax of 11*s.* 6*d.* in the pound on unearned income. This figure is, I hope, needlessly high. To arrive at it he assumed that peace might be concluded towards the end of 1919, and that when peace conditions are fully re-established—which will take, he thinks, three years, the National Debt will amount to £10,000 millions, involving annual interest of £500 millions, which, added to the total Rente of the country in 1913 (which he made out to be £520 millions), will make a total Rente in 1923 of £1020 millions. His view is that the burden of the National Debt should be thrown by means of the income tax upon the national Rente, not taxing it out of existence, but by such a scale of taxation as would reduce the net Rente of the country to

approximately the level at which it stood before the war.

There is good reason to hope that Mr Hoare's figures will not be reached. He took £10,000 millions merely as a round sum. Mr Bonar Law, it will be remembered, worked out our net debt on March 31st next at £6856 millions, taking credit for half the estimated amount of loans to Allies as a good asset. If we prefer as sounder bookkeeping to write off the whole of our loans to Allies for the time being and to apply anything that we may hereafter receive on that account to Sinking Fund, the debt, on the Chancellor's figures, will amount on March 31st (if the war goes on till that date) to £7672 millions. Even if the war went on for six months more it ought not to bring the debt up to more than £9000 millions at the outside. It is quite true, as Mr Hoare says, that the return to peace conditions will be a gradual process, and that expenditure will not come back to a peace basis all at once. Demobilisation and other matters which were left, by our cheery Chancellor, out of the airy after-war balance-sheet that he so light-heartedly constructed, may cost £1000 millions or more before we have done with them. But against them we can set a string of recoverable assets which, in the Chancellor's hands, footed up a total of £1172 millions—balances in agents' hands, due debts (apart from loans to Allies), land, securities, ships, buildings, stores in Munitions Department, arrears of taxation, and so on. With his 11*s.* 6*d.* in the pound on unearned and 6*s.* in the pound on earned incomes, Mr Hoare expects a revenue of £620 millions, " or

enough to provide for the interest of the debt with a 1 per cent. Sinking Fund, and leave £20 millions towards the Supply Services." But Mr Bonar Law anticipated a total peace Budget (if the war ended by March 31st next) of £650 millions. This was probably too low, but we may at least hope that Mr Hoare has gone rather further than was necessary to be on the safe side.

In the other article on the subject of post-war debt contributed to the last number of this Journal, an "Ex-M.P." plumped for a somewhat novel variety of the Levy on Capital, in the shape of a Compulsory Loan, bearing no interest and repayable in 100 years. Each individual citizen to be made to subscribe to the extent of 20 per cent. of his possessions. Ten per cent. of the amount due to be paid on application, 10 per cent. six months after allotment, and 80 per cent. on January 1st of the following year. When desired, the Government to advance at 5 per cent. the money necessary for the payment subsequent to allotment, full repayment of such advances to be made within eight years. A Sinking Fund to be established to redeem the loan at maturity. But is there any real advantage in this scheme over the Levy on Capital, from which it only differs by the receipt by the payer of a promise to repay in 100 years' time? The approximate value of £1000 nominal of the Compulsory Loan stock would be, according to "Ex-M.P.'s" calculation, in the year of issue £7 12*s.*, money being worth 5 per cent. and assuming that rate to be current during the remainder of the term. The claim that there is no confiscation,

because "a perfectly good security is given for the money received," would seem rather futile to those who paid £1000 and received a security, the present value of which might be below £10. They might very likely think that outright confiscation (since confiscation originally means nothing but "putting into the Treasury") is really a simpler way of dealing with the problem. "Ex-M.P.," however, estimates that the immediate redemption of £2800 millions of debt (which he, rather modestly, expects to be the result of his 20 per cent. levy) would enable the balance of the War Debt to be converted into $3\frac{1}{2}$ per cent. stock. This may be true, but if so it is equally true if a similar or larger amount of debt is cancelled by means of an outright Levy on Capital.

The merits and demerits of a Levy on Capital have already been dealt with in the pages of this Journal. "Ex-M.P.," however, brought forward a slightly novel form of argument in its favour. He pointed out that the money constituting the great increase in debt that has taken place during the war will have been, in the main, contributed by people who have worked at home under the protection of the Army and Navy, while the soldiers and sailors have been prevented by the duty which sent them out to risk their lives from subscribing a proportionate share to the National Debt. Hence "a class that deserves most of the State will find itself indebted to a class which—if it does not deserve least of the State—has, at any rate, turned a national emergency to personal profit." This is a strong argument, which has been used frequently in the course of the war in the pages

of the *Economist*, against borrowing for war purposes to the large extent to which our timid rulers have adopted the policy. "To be really just," the writer continued, "the process of taxation . . . must be applied with greatest force to those who have accumulated their money since the outbreak of war, and only to a less degree to those whose fortunes have not been built upon their country's necessity. The difficulty of separating these two classes of wealth is great, and must, in the writer's opinion, be effected by separate legislation—legislation which might justly be based upon the increase in post-1913 incomes, a record of which should now be in preparation at Somerset House." Everyone will agree that everything possible should be done to take the burden of the war debt off the shoulders of those who have fought for us; but it is equally clear that now that the mischief of this huge debt has been done, it will be exceedingly difficult to repair it by any ingenuities of this kind. For instance, if the kind of taxation—in the shape of a Compulsory Loan—proposed by "Ex-M.P." were enforced, how can we be sure that it would not take a large slice off capital, the next heir to which is a soldier or a sailor? Bad finance is so much easier to perpetrate than to remedy that one is almost certain to come across such objections as this to any scheme for making the war profiteers "cough up" some of their gains.

Moreover, we have to remember that by no means the whole of the war debt represents the gains of those who "have turned a national emergency to personal profit." Some people whose incomes have

been actually decreased by the war, especially when currency depreciation is taken into account, have, in response to the appeals of the War Savings Committee, saved more than they ever saved before by patriotically stinting themselves. And even the savers who have saved out of war profits were so far more patriotic than the war profiteers who did not save but squandered. In all the discussion concerning the Levy on Capital I have not seen any answer (even in Mr Pethick Lawrence's very persuasive little book in its favour) to the three great objections to it (1) that it lets off the squanderer and penalises the saver; (2) that the difficulty, trouble and expense involved by the necessary valuation, and the iniquities and frauds that are almost certain to arise out of it, will be enormous; and (3) that its economic effect may be very serious in discouraging accumulation. "Why should any one save," the unthrifty soul will most naturally ask, "if his savings are liable to have a slice cut out of them by a levy at any time?" The advocates of the Levy, and "Ex-M.P." in his advocacy of a Compulsory Loan for repayment of debt, assume that it can be done once and for all and never again. "Take one-fifth of a man's savings away as an emergency measure not to be repeated, and he will at once endeavour to save it back again." But how will you persuade him that it is an emergency measure not to be repeated? How can you be sure that it is so? I have heard a very distinguished Socialist, discussing in private the beauties of the Levy on Capital, point out that it is the sort of thing which, when once the ice has

been broken, can be done again so easily. From the Socialist point of view the Levy on Capital is, of course, a simple means of getting, by repetitions of it at regular intervals, all the means of production into the hands of the State; but would the State make a good use of them?

Another assumption about the Levy on Capital that seems to me to be the merest will o' the wisp is the delusion that the whole saving that it would entail by reducing the debt charge would necessarily and certainly go to the relief of income tax. On this assumption Mr Pethick Lawrence bases his most persuasive appeal to the smaller income-tax payer, by showing that he would be better off after a Levy on Capital than before it, thanks to the reduction in income tax, which is assumed as axiomatically arising in its train. But is this certain or even likely? Is it not much more probable that our Government, finding its post-war Budget greatly lightened by a Levy on Capital or a Compulsory Loan to redeem debt, will think itself free to indulge in extravagance, maintaining a considerable part of the war income tax and wasting it on rash experiments? All these weaknesses, which appear to be inherent alike in the Levy on Capital or in the scheme which gilds the pill by calling it a Compulsory Loan, seem to be ignored or neglected (perhaps because they are unanswerable) by their advocates. On the other hand, there are certain psychological arguments on the other side. If the well-to-do, who would have to pay the Levy or subscribe to the Compulsory Loan, would prefer that system to a high income tax,

there is no more to be said. A tax that is popular with the payer, as compared with other modes of shearing his fleece, needs no further recommendation. But, in view of the probability of the experiment, once tried, being shortly and frequently repeated, I very much doubt whether this is so ; as far as I have been able by personal inquiry to test opinion on the point I have found it almost unanimously adverse among those whom the Levy would most seriously affect. If, as is much more likely, the imposition of a Levy created better feeling among the working classes and the returning soldiers and tended to more harmonious co-operation in after-war tasks of reconstruction, it might be worth while to face its evils and its dangers. But here again it is quite probable that if the burden of war debt were clearly and palpably put on the shoulders best able to bear it, that is, on those who are lifted by the gifts of fortune—either in inherited money or unusual brain-power or faculties—by an equitably graded income tax, the effect might be just as good on the minds of those who suspect that the rich have battened throughout the war on exploitation of the poor.

This much at least seems to be agreed by most reasonable people about the debt charge—that it will have to be raised, either by a Levy on Capital or by income tax or some other form of direct taxation, from those who are blessed with a margin. We are not likely to repeat our ancestors' mistake, after the Napoleonic War, of throwing the whole burden on to the general consumer by indirect taxation of necessaries and of articles of general consumption.

Even Tariff "Reformers" say little about the revenue that their fiscal schemes would bring in. And with good reason. For in so far as they secured Protection they would bring in no revenue; we cannot at once keep out foreign goods and tax them; and any revenue that they brought in would be most expensively raised, because a large part of the extra price paid by the consumer would go not to the State but into the pockets of the home producer. Nor is it likely that any of the many schemes—of which Mr Stilwell's "Great Plan, How to Pay for the War," is a particularly bold example—for paying off debt by a huge issue of inconvertible currency, will achieve any practical result. Not only would they defraud the debt-holder by paying him off in currency enormously depreciated by the multiplication of it that would be involved; but they would also, by that depreciation, throw the burden of the debt on the shoulders of the general consumer through a further disastrous rise in prices, and so would accentuate the bitterness and discontent already rife owing to the war-time dearness and all the suspicions of profiteering and exploitation that it has engendered.

After all, this problem of the war debt, in so far as it is held at home, is not one that ought to terrify us if we look at it steadily. People talk and write as if when the war is over the business of paying for it will begin. That is not really so. The war has been paid for as it went on, and, except in so far as it has been financed by borrowing abroad, it has been paid for by us as a nation. Whatever we have used for

the war we have paid for as it went on, partly with the help of loans from America and from other countries—Argentina, Holland, Switzerland, etc.—that have lent us money. These loans amount, as far as they can be traced from the official figures, to about £1300 millions. Against them we can set our loans to our Dominions, over £200 millions (a perfectly good asset), and our loans to our Allies, perhaps £1500 millions, which the Chancellor proposes to write down by 50 per cent., and might perhaps treat still more drastically. To meet this foreign debt we shall have to turn out so much stuff—goods and services of all kinds—for sale abroad to meet the interest and repayment. We have further impoverished ourselves by selling our foreign securities abroad. No figure has been published giving any clue to the amount of these sales, and we may perhaps guess them at £1000 millions. If the pre-war estimates of our overseas investments at £4000 millions were anywhere near the mark, it thus appears that we shall end the war still a great creditor nation.

In so far as the debt was raised at home, the war was paid for by those who bought the securities offered, and we have now to pay them interest and set about repaying them the capital. This process will not diminish the national wealth, but will only affect its distribution. It will not diminish the amount of available capital, but may even rather increase it by gathering into the hands of the debt-holders—who are ex-hypothesi folk with an inclination for saving—money that might, if left in the

hands of those from whom it is collected, have been squandered. The payment of the debt charge merely means that those who came forward with their money when they were asked to subscribe to war loans, have, according to the extent of the effort that they then made, a set-off against the subsequent taxation involved by the war debt. It would have been a much simpler and more businesslike proceeding to have taken, instead of borrowing, a much larger proportion of the war's cost during the war; but it is too late now to rub in this platitude which is now pretty generally admitted. Mr Hoare showed in last month's Journal that the creation of the War Debt has caused a huge addition to what he has called Rente—the gross income of the propertied classes; and there is much logic in his contention that this income is the source from which the debt charge should be met. At the same time both justice and economic expediency seem to demand that his wider interpretation of Rente, to make it include the earnings of those whose special qualifications (or, we may add, special luck) put them in a position to earn more easily than the struggling majority, should be applied to taxation involved by the debt charge.

How, then, shall we deal with the debt? In the first place we want a good Sinking Fund—1 per cent. at least—and all realisations of assets in the shape of loans repaid, ships, etc., sold, should be used for reduction of our foreign debt. For the home charge we want a special form of income tax that will fall as lightly and indirectly as possible on industry; that

is, that it should be imposed on the individual taxpayer direct. So that what we want is an extended, reformed and better graduated form of the super-tax brought down so low that every one who is not merely rich but comfortable should pay his share. For example, any single man or woman with any excess over £500 a year of unearned income, or over £800 a year of earned income might well pay supertax on that excess. The exemption limit might well be raised by 50 per cent. for married couples (if their joint incomes are still to be counted as one), and by £100 a year for each child between the age of five and twenty-five. But all these figures are mere suggestions, and the details of the scheme would have to be worked out by Inland Revenue officials, whose experience and knowledge of the practical working of such matters qualifies them for the task. The broad principle is a special tax for the debt charge to be raised direct from individual incomes with skilful differentiation, according to the circumstances of the taxpayer, in the matter of the number of his dependants, and also according to the source of the income, whether it is being earned by exertions which illness might terminate or received from invested funds, and therefore beyond the reach of the "slings and arrows of outrageous fortune." That portion of the tax that is required for Sinking Fund might be made payable, at the option of the taxpayer, in Government securities at prices giving some advantage to the holder. This form of special debt-charge supertax would enable the ordinary income tax to be reduced considerably at once. Mr Edward Lees,

secretary to the Manchester and County Bank, has put forward a scheme by which taxpayers can buy in advance immunity for so many years from so much annual income tax. If this suggestion could be worked it might provide a means of quickening the debt's repayment, though it looks rather like exchanging one form of debt for another. But, in any case, it is urgent that the long promised reform of income tax should be set in hand at once, so that it may be purged of its present inequities and anomalies and set to work in peace to redeem debt on a new and more scientific basis.

XVI

THE CURRENCY REPORT

December, 1918

Currency Policy during the War— Its Disastrous Mediævalism— The Report of the Cunliffe Committee—A Blast of Common Sense—The Condemnation of our War Finance—Inflation and the Rise in Prices—The Figures of the Present Position —The Break in the Old Relation between Legal Tender and Gold—How to restore it—Stop Borrowing and reduce the Floating Debt—Return to the Old System—The Committee's Sane Conservatism—A Sound Currency vital to National Recovery.

Among the many features of the late war (how comfortable it is to talk about the "late war"!) that seem likely to astonish the historian of the future, perhaps the thing that will surprise him most is the behaviour of the warring Governments in currency matters. It is surely a most extraordinary thing after all that has been thought, said and written about monetary policy since money was invented that as soon as a great economic effort was necessary on the part of the leading civilised Powers, they should all have fallen back on the old mediæval dodge of depreciating the currency, varied to suit modern needs, in order to pay part of their war bill, and should have continued this policy throughout the course of the war, in spite of the obvious results that it was producing in the shape of unrest, suspicion and

bitterness on the part of the working classes, who very naturally thought that the consequent rise in prices was due to the machinations of unscrupulous capitalists who were exploiting them. It is even possible that the historian of a century hence may ascribe to this cause the beginning of the end of our present economic system, based on the private ownership of capital, for it is very evident that we have not yet seen the end of the harvest that this bitterness and discontent are producing.

A less important but still very objectionable consequence of the flood of currency and credit that the Government has poured out to fill a gap in its war finance is the encouragement that it has given to a host of monetary quacks who believe that all the financial ills of the world can be saved if only you give it enough money to handle, oblivious of the effect on prices of mere multiplication of claims to goods without a corresponding increase in the volume of goods. These enthusiasts have seen that during war a Government can produce money as fast as it likes, and since they think that producing money makes every one happy they propose to adopt this simple method for paying off war debt, restarting trade and generally creating a monetary millennium. How far their nostrums are likely to be adopted, no one can yet say, but some of the utterances of our rulers make one shudder.

Into this atmosphere of quackery and delusion the report of the Committee on Currency and Foreign Exchanges breathes a refreshing blast of sound common sense. Everybody ought to read it. It

costs but twopence ; it is only a dozen pages long, and it is described (if you want to order it) as Cd. 9182. In view of the many attacks that have been made on our banking system—especially the Bank Act of 1844—by Chambers of Commerce and others before the war, it is rather surprising that so little criticism should have been heard of this Report, which practically advocates a return, as rapidly as possible, to the practice and principles imposed by that Act. It may be that peace, and all the pre-occupations that have followed it, have absorbed men's minds so entirely that questions of currency seem to be an untimely irrelevance ; or possibly the very heavy weight of the Committee's authority may have silenced the opposition to its recommendations. Presided over by Lord Cunliffe, the late Governor of the Bank, and including Sir John Bradbury and Professor Pigou and an imposing list of notable bankers, it was a body whose opinion could only be challenged by critics gifted with the most serene self-confidence.

One of the most interesting—especially to advocates of sound finance—points in its Report is the implied condemnation that it pronounces on the methods by which the war has been financed by our rulers. It points out that " the need of the Government for funds wherewith to finance the war in excess of the amounts raised by taxation or by loans from the public has made necessary the creation of credits in their favour with the Bank of England. . . . The balances created by these operations passing by means of payments to contractors and others to the

Joint Stock banks have formed the foundation of a great growth in their deposits, which have also been swelled by the creation of credits in connection with the subscriptions to the various War Loans. . . . The greatly increased volume of bank deposits, representing a corresponding increase of purchasing power and, therefore, tending in conjunction with other causes to a great rise of prices, has brought about a corresponding demand for legal tender currency which could not have been satisfied under the stringent provisions of the Act of 1844." Here we have the story of bad war finance put as clearly as it can be. Because the Government was not able to raise all the money needed for the war on sound lines—that is, by taxation and loans to it of money saved by investors—it had recourse to credits raised for it by the Bank of England and the other banks against Treasury Bills, Ways and Means Advances, War Loans, War Bonds, and loans to customers who were taking up War Loans, etc. Thereby as these credits created fresh deposits there was a huge increase in the community's purchasing power; and since the supply of goods to be purchased was stationary or reduced, the only result was a great increase in prices which made the war, perhaps, nearly twice as costly as it need have been and produced all the suspicion and unrest that has already been referred to. Considering that the Committee included an ex-Governor of the Bank and the Permanent Secretary to the Treasury it could hardly have been expected to use much plainer language concerning the failure of our rulers to get money out of us

in the right way for the war and the vigour with which they made use of the demoralising weapon of inflation.

It followed as a necessary consequence that the volume of legal tender currency had to be greatly increased. As prices rose wages rose with them, and so much more "cash" was needed in order to pay for a turnover of goods which, fairly constant in volume, demanded more currency because of their inflated prices. As the Committee says in its Report (page 5): "Given the necessity for the creation of bank credits in favour of the Government for the purpose of financing war expenditure, these issues could not be avoided. If they had not been made, the banks would have been unable to obtain legal tender with which to meet cheques drawn for cash on their customers' accounts. The unlimited issue of currency notes in exchange for credits at the Bank of England is at once a consequence and an essential condition of the methods which the Government have found necessary to adopt in order to meet their war expenditure."

The effect of these causes upon the amount of legal tender currency (other than subsidiary coin) in the banks and in circulation is summarised by the Committee in the following table:—

"The amounts on June 30, 1914, may be estimated as follows:—

Fiduciary Issue of the Bank of England	£18,450,000
Bank of England Notes issued against gold coin or bullion	38,476,000

Estimated amount of gold coin held by Banks (excluding gold coin held in the Issue Department of the Bank of England) and in public circulation	123,000,000
Grand total	£179,926,000

"The corresponding figures on July 10, 1918, as nearly as they can be estimated, were :—

Fiduciary Issue of the Bank of England	18,450,000
Currency Notes not covered by gold	230,412,000
Total Fiduciary Issues * ...	£248,862,000
Bank of England Notes issued against coin and bullion	65,368,000
Currency Notes covered by gold ...	28,500,000
Estimated amount of gold coin held by Banks (excluding gold coin held by Issue Department of Bank of England), say	40,000,000
Grand total	£382,730,000

"There is also a certain amount of gold coin still in the hands of the public which ought to be added to the last-mentioned figure, but the amount is unknown."

It will be noted that the gold held by the banks (other than the Bank of England) and by the public has declined from £123 to £40 millions, according to the

* The notes issued by Scottish and Irish banks which have been made legal tender during the war have not been included in the foregoing figures. Strictly the amount (about £5,000,000) by which these issues exceed the amount of gold and currency notes held by those banks should be added to the figures of the present fiduciary issues given above.

Committee's estimate, while, on the other hand, the circulation of bank notes has risen by £27 millions and the issue of currency notes has taken place to the tune of £259 millions (at the date of the Report ; it is now nearly £300 millions), making a net addition to legal tender currency of over £200 millions. When we also remember that there has been a very heavy coinage of silver and copper, that the Bank of England's deposits have risen by over £100 millions and the deposits of the other banks by nearly £700 millions, and all this at a time when most of the industrial activity of the country was going into the production of destructive weapons and the support of those who were using them, the behaviour of commodities of ordinary use in rising by nearly 100 per cent. seems to be an example of remarkable moderation. With all this new buying power in the hands of the community there is little wonder that some people should think that we have enormously increased our wealth during this most destructive and costly war, and should then feel hurt and disappointed when they find that this new buying power is robbed of all its beauty by the fact that its efficiency as buying power is seriously diminished by its mere quantity.

Such being the state of affairs—a great mass of new credit and currency based on securities—it is clear that our currency has been deprived for the time being of that direct relation with its gold basis that used in former time to regulate its volume according to world prices and our international trade position. As the Committee says, " It is not possible

to judge to what extent legal tender currency may in fact be depreciated in terms of bullion. But it is practically certain that there has been some depreciation, and to this extent therefore the gold standard has ceased to be effective." Very well, then, what has to be done to get back to the old state of things under which there was a more or less automatic check on the creation of credit and the issue of currency? This check worked by a system which was elastic and simple. It was not entirely automatic, because its working had to be controlled by the Bank of England, which, by the action of its discount rate, could, more or less, quicken or check the working of the machine. Legal tender currency could only be increased by imports of gold; and exports of gold reduced the available amount of legal tender currency; and since a stock of legal tender currency was essential to meet the demands upon them that bankers made possible by creating credits, there was thus an indirect and variable connection between the country's gold stock and the extent to which bankers would think it prudent to multiply credits. If credits were multiplied too fast, our currency was depreciated in value as compared with those of other countries and the exchanges went against us and gold either was exported or began to look as if it might be exported. If it was exported the legal tender basis of credit was reduced and the creation of credit was checked. If the Directors of the Bank of England thought it inadvisable that gold should be exported they could, by raising the rate of discount and taking artificial measures to control

the supply of credit, produce, without the actual loss of gold, the effects which that loss would have brought about.

The keystone of the system was the rigid link between legal tender currency and gold. This was secured by the provisions of the Bank Act of 1844, which laid down that above a certain line—which was before the war roughly £18½ millions—every Bank of England note issued should have gold behind it, pound for pound. In other words, the Bank of England note was, for practical purposes, a bullion certificate. The legal limit on the fiduciary issue (that is, the issue of £18½ millions against securities, not gold) could only be exceeded by a breach of the law. The many critics of our banking system seized on this hard-and-fast restriction and accused it of making our system inelastic as compared with the German arrangement, under which the legal limit could at any time be exceeded on payment of a tax or fine on any excess perpetrated. These critics might have been right if legal tender currency had been the only, or even the predominant, means of payment in England. But, as every office boy knows, it was not. Legal tender—gold and Bank of England notes—was hardly ever seen in commercial and financial transactions on a serious scale. We paid, sometimes, our retail purchases of goods and services in gold; and Bank notes were a popular mode of payment on racecourses and in other places where transactions took place between people who were not very certain of one another's standing or good faith. But the great bulk of payments was

made in the cheque currency which our bankers had developed outside of the law and could create as fast as prudence—and an eye to the supply of legal tender which every holder of a cheque had a right to demand —allowed them to do so. While cheques provided the currency of commerce, another form of " money " was produced, again without any restriction by the Act, by the pleasant convention which caused a credit in the Bank of England's books to be regarded as " cash " for balance-sheet purposes by the banks. These advantages gave the English system a freedom and elasticity, in spite of the strictness of the law that regulated the issue of paper currency, that enabled it to work in a manner that, judged by the test of practical results, had one great advantage over that of any of the rival centres. It alone in days before the war fulfilled the functions of an international banker by being ready at all times and without question to pay out the gold that was, in the last resort, the final means of settling international balances.

It is the object of Lord Cunliffe's Committee to restore as quickly as possible the system which has thus been tried by the test of experience. " After the war," they say in their Report, " our gold holdings will no longer be protected by the submarine danger, and it will not be possible indefinitely to continue to support the exchanges with foreign countries by borrowing abroad. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more

brought into play there will be very grave danger of a credit expansion in this country and a foreign drain of gold which might jeopardise the convertibility of our note issues and the international trade position of the country. . . . We are glad to find that there was no difference of opinion among the witnesses who appeared before us as to the vital importance of these matters." The first measure that they put forward as essential to this end is the cessation at the earliest possible moment of Government borrowings. "A large part of the credit expansion arises, as we have shown, from the fact that the expenditure of the Government during the war has exceeded the amounts which they have been able to raise by taxation or by loans from the actual savings of the people. They have been obliged therefore to obtain money through the creation of credits by the Bank of England and the Joint Stock banks, with the result that the growth of purchasing power has exceeded that of purchasable goods and services." It is therefore essential that as soon as possible the State should not only live within its income but should begin to reduce indebtedness, especially the floating debt, which, being largely held by the banks, has been a cause of credit creation on a great scale. "The shortage of real capital must be made good by genuine savings. It cannot be met by the creation of fresh purchasing power in the form of bank advances to the Government or to manufacturers under Government guarantee or otherwise, and any resort to such expedients can only aggravate the evil and retard, possibly for generations, the recovery

of the country from the losses sustained during the war." With these weighty words the Committee brushes aside a host of schemes that have been urged for putting everything right by devising new machinery for the manufacture of new credit. That new credits will be needed for industry after war is obvious, but what else are our banks for, if not to provide it? They can only be set free to provide it on the scale required if, by the necessary reduction of the floating debt, they are relieved of the locking up of their funds in Government securities, which has been one of the bad results of our bad war finance.

It goes without saying that the Committee does not recommend the continuance in peace of the differential rates for home and foreign money that were introduced as a war measure with a view to lowering a rate at which the Government borrowed at home for war purposes. It would evidently be too severe a strain on human nature to attempt to work such a system, except in war-time, when the artificial conditions by which the market was surrounded made it both feasible and desirable to do so. With regard to the note issue, the Committee proposes a return to the old system and a strictly drawn line for the amount of the fiduciary note issue, the whole note issue (with the exception of the few surviving private note issues) being put into the hands of the Bank of England, all notes being payable in gold in London only and being made legal tender throughout the United Kingdom. These suggestions are subject to any special arrangements that may be made with regard to Scotland and Ireland.

An early resumption of the circulation of gold for internal purposes is not contemplated. The public has become used to paper money, which is in some ways more convenient and cheaper ; and the luxury of a gold circulation is one that we can hardly afford at present. Gold will be kept by the Bank of England in a central reserve, and all the other banks should, it is suggested, transfer to it the whole of their present holdings of the metal. In order to give the Bank of England a closer control of the bullion market the Committee thinks it desirable that the export of gold coin or bullion should, in future, be subject to the condition that such coin or bullion had been obtained from the Bank for the purpose. This measure would give the Bank of England a very close control of the bullion market, so close that there is a danger that if this control were too rigorously exercised, gold that now comes to this country might be diverted, with a view to more advantageous sale, to other centres. The amount of the fiduciary issue is a matter that the Committee leaves open to be determined after experience of post-war conditions. They " think that the stringent principles of the Act (of 1844) have often had the effect of preventing dangerous developments, and the fact that they have had to be temporarily suspended on certain rare and exceptional occasions (and those limited to the earlier years of the Act's operation, when experience of working the system was still immature) does not," in their opinion, invalidate this conclusion. So they propose that the separation of the Issue or Banking Departments

should be maintained, but that in future if an emergency arose requiring an increase in the amount of fiduciary currency, this should not involve a breach of the law, but should be made legal (as it is now under the Currency and Bank Notes Act of 1914), subject to the consent of the Treasury.

It is not proposed at present to secure the circulation of paper instead of gold by legislation. The Committee considers that "informal action on the part of the banks may be expected to accomplish all that is required." If necessary, however, it points out that the circulation of gold could be prevented by making the notes convertible, at the discretion of the Bank of England, into coin or bar gold. The amount which, in the opinion of the Committee, should be aimed at for the central gold reserve is £150 millions (a sum which is already almost in sight on its figures quoted above); and "until this amount has been reached and maintained concurrently with a satisfactory foreign exchange position for a period of at least a year," it thinks that the policy of reducing the uncovered note issue "as and when opportunity offers" should be consistently followed. How this opportunity is going to "offer" is not made clear; but presumably a reflow of notes from circulation can only happen through a fall in prices or a reduction in bank deposits by the liquidation of advances made to the Government, directly or indirectly, by the banks.

Concerning the difficult problem of replacing the Bradbury notes by Bank of England notes of £1 and 10s., an ingenious suggestion is made by the

Committee. It observes that there would be some awkwardness in transferring the issue to the Bank of England before the future dimensions of the fiduciary issue have been arrived at; and it suggests that during the transitional period any expansion in Treasury notes that may take place should be covered, not as now, by Government securities, but by Bank of England notes taken from the Bank. By this means any demands for new currency would operate in the normal way to reduce the reserve of the Banking Department, " which would have to be restored by raising money rates and encouraging gold imports," and so a step would have been taken to getting back to a business basis in the currency system and away from the profligate printing-press policy of the war period.

Such are the suggestions made by this distinguished body for the restoration of our currency. Little has been said against them in the way of serious criticism, but their conservative tendency and the fact that they practically recommend a return to the *status quo* has caused some impatience among the financial Hotspurs who proposed to begin to build a new world by turning everything upside down. In matters of finance this process is questionable, interesting as the result would undoubtedly be. To get to work on tried lines and then, when once industry and finance have recovered their old activity, to amend the machine whenever it is creaking seems to be a more sensible plan than to delay our start until we have fashioned a new heaven and earth, and then very probably find that they

do not work. If the machine is to be set moving, it can only be done by close co-operation between the Bank of England and the other banks which have grown by amalgamation into institutions the size of which seem likely to make the task of central control more difficult than ever. On this important point the Committee is curiously silent. But it recommends the adoption of a suggestion made by a Committee of Bankers, who proposed that banks should in future be required " to publish a monthly statement showing the average of their weekly balance-sheets during the month." (Will this requisition apply to the Bank of England ?) This is a welcome suggestion as far as it goes, but unless something is done by co-operative action to make the Bank rate more automatic in its influence on the actions of the other banks, the difficulty of making it effective seems likely to be considerable.

Getting the currency right is a most important matter for the future of our financial position. Another is the question of our debt to foreigners. Most of this debt we owe to America, and we only owe it because we had to finance our Allies. We surely ought to be able to arrange with America that anything that we have to do in giving our Allies time before asking for repayment they also should do for us—within limits, say, up to thirty years. In view of all that they have made and we have lost by this war waged for the cause of all mankind, this would seem to be a reasonable concession on America's part.

XVII

MEETING THE WAR BILL

January, 1919

The Total War Debt—What are our Loans to the Allies worth?—Other Uncertain Items—The Prospects of making Germany pay—The Right Way to regard the Debt—Our Capital largely intact—A Reform of the Income Tax—The Debt to America—The Levy on Capital and other Schemes—The only Real Aids to Recovery.

A TABLE published week by week by the *Economist* shows that from August 1, 1914, to November 9, 1918, the Government paid out £8612 millions sterling. From this we have to deduct an estimate of the amount that the Government would have spent if there had not been a war, so that we are at once landed in the realm of conjecture. The last pre-war financial year saw an expenditure of £198 millions, and it is safe to assume that this figure would have swollen by a few millions a year if peace had continued, so that we may take at least £860 millions from the above total as normal peace expenditure for the 4¼ years. This gives us £7752 millions as the gross cost of the war, as far as the period of actual fighting is concerned. From this figure, however, we are able to make some big deductions. There are loans to Allies and Dominions, and some other much more readily realisable assets than

these. We do not know the actual figure of the loans to Allies and Dominions during the war period, because they are not included in the weekly financial statements. The amount that we borrow abroad is set out week by week—at least, that is believed to be the meaning of the cryptic item "Other Debt"—but the amount that we lend to Allies and Dominions is hidden away in the Supply Services or somewhere, and we only get occasional information about it from the Chancellor in the course of his speeches on the Budget or on Votes of Credit. In his last Vote of Credit speech, on November 12, 1918, Mr Bonar Law gave the chief items of the loans to Allies, and a very interesting list it was. The totals up to October 19, 1918, were £1465 millions to Allies and £218½ millions to Dominions. The Allies were indebted to us as follows:—Russia, £568 millions; France, £425 millions; Italy, £345 millions; smaller States, £127 millions.*

Some of these debts may be written off at once, and that cheerfully, seeing that they have been lent brothers-in-arms who have been hit much harder than we have by the war, and had nothing like our financial strength. The question is, what figure ought we to put on this asset in deducting it from gross war expenditure in order to arrive at a guess at the real cost? We take our loans to Dominions, of course, as good to the last penny. Mr Bonar Law, in his Budget speech last April, took our loans to Allies at half their face value. Strict book-keeping would probably demand a lower figure than 50 per

* Parliamentary Debates, Vol. 110, No. 114, p. 2560.

cent. ; but let us follow the ex-Chancellor's example and take loans to Allies, which we will estimate at £1480 millions up to November 9th, as good for £740 millions, and loans to Dominions at £220 millions up to the same date, a total of £960 millions, to be deducted from gross war cost. Concerning £740 millions of this sum, however, there is a certain amount of doubt. No one questions for a moment the solvency of France and Italy, but in view of the pressure that the war has exercised on their producing power, and, in the case of France, the complication added by the uncertainties of the position in Russia, in which French investors are so deeply interested, one cannot feel sure that they will be able at once to make interest payments. Much will depend on the sums that they are able to recover from Germany against their bill of damages, on which more anon. But in any case it seems likely that a general scheme of interest funding, as between the Allies, may have to be adopted for some years to come.

As to the other assets that we have to set against our gross expenditure during the fighting period, they were enumerated by the Chancellor in his Budget speech last April in the following terms :—

Balances in agents' hands, debts due, foodstuffs, etc.	£375 millions.
Land, securities, buildings and ships	97 ,,
Stores in Munitions Department (cost price 325 millions) taken at	100 ,,
Additions this financial year ...	100 ,,
Arrears of taxation	500 ,,
*Total	£1172 ,,

* Parliamentary Debates, Vol. 105, No. 33, pp. 698-699.

It will be remembered that in his Budget speech the Chancellor was proceeding on the assumption that the war would last till March 31st next—the date at which our financial year ends—and would then be convenient enough to stop. Happily for us, the valour of our soldiers and those of our Allies, the splendid success of our Fleet and our merchantmen in bringing over American troops and their food and equipment with astonishing speed, and the straightforward diplomacy of President Wilson, combined to achieve victory nearly five months earlier than the most sanguine had dared to expect. With the very pleasant result—though it is a small matter when compared with the end of the killing of the best of our manhood—that the financial position is very greatly improved. With regard to the figures given above, it should be observed that the " debts " are advances to Dominions, but on quite a different basis from our loans to them, being money owed by them against goods and services supplied.* They and the balances in the hands of agents are both as good as gold. Concerning the others, one is entitled at first sight to feel a good deal of scepticism, since such articles as land, buildings, ships and stores, bought or built by Government during a war, are likely to find an extremely sluggish demand when the war is over. However, Mr Bonar Law assured the House that his valuation of these amounts had been arrived at on a conservative basis, and, what is better still, in his Vote of Credit speech on November 12th, he was able to state that revised estimates had shown

* Parliamentary Debates, Vol. 105, No. 33, p. 698.

that their value would be " far greater " than he had previously expected. So perhaps we are entitled to take them at £1300 millions.

If so, we get the following results for the cost of the fighting period :—

Total Government expenditure, August 1, 1914, to November 9, 1918		£8612	millions.
Less estimate of normal peace expenditure		860	,,
		7752	,,
Less Loans to Dominions ...	220 millions.		
Less Loans to Allies (half face value)	740 ,,		
Realisable assets ...	1300 ,,		
		2260	,,
Net cost of period		£5492	,,

If war cost would be good enough to cease with the fighting we should thus now be able to see, more or less, how we stand. During the fighting period the Government raised by taxation the sum of £2120 millions,* from which we have again to deduct £860 millions as an estimate for normal peace taxation, if the war had not happened, leaving £1350 millions as the net war taxation, and £4142 millions as the net addition to debt from the war.

But, of course, there are still some large and uncertain sums to come in to both sides of the account. There is the cost of maintaining our Army

* *Economist*, Nov. 16, 1918.

and Navy during the armistice period, the cost of demobilisation, and the cost of putting an end to war munitions contracts running for many months ahead, holders of which will have to be compensated. Who has enough assurance to venture on an estimate of the cost of these items? Shall we guess them at something between £1000 and £1500 millions? And when we have made this guess are we at the end of the war's cost? Ought we not to include pensions to be paid, and if so, at what figure? Fifty millions a year for thirty years? If so, there is another £1500 millions. And interest on war debt, and for how long?

On the other side of the balance-sheet, the only asset that has not yet been included in the calculation is the sum that we are going to receive from Germany. Some cheery optimists think that it is possible for us and for the Allies to make Germany pay the whole of our war cost. If so, we have halcyon days ahead, for not only shall we be able to repay the whole war debt but also to pay back to the taxpayer all the £1350 millions that he produced during the war, unless, as seems more likely, the Government finds other uses, or abuses, for the money, and sets its motley horde of wasters to work again. But this problem, of course, is not going to arise. It would not be physically possible for Germany to pay the whole of the Allies' war cost, except in the course of many generations, and, moreover, the Allies have bound themselves not to make any such demand by the rider that they added to President Wilson's peace terms, in giving their assent to them as the

basis on which they were prepared to make peace. Early in November they stated that President Wilson's reference to "restoration" of invaded countries should, in their view, be expanded into a claim for compensation "for all damage done to the civilian population of the Allies and to their property by the aggression of Germany by land, by sea, and from the air." * This is letting Germany off lightly; but, after stating their readiness to make peace on the basis of the fourteen points, if amended as above (and also with regard to the Freedom of the Seas question) it is not possible for the European Allies, as the Prime Minister's late manifesto says they propose to do,† to expand this claim for civilian damage into a demand for the whole of their war cost up to the limit of the capacity of the Central Powers to pay, without a serious breach of faith. So that the question of how much we can get out of Germany is complicated by the further uncertainty of the size of the bill for damages that we can present. It will be big enough. We know that the Germans have sunk $8\frac{1}{2}$ million tons of British ships during the war. As to the price at which, for "restoration" purposes, we shall value those ships and their cargoes, and all the civilian property damaged by aircraft and bombardment, this is a matter which it would be obviously improper to discuss; but we may be sure that the bill will mount up to many hundreds of millions, and it remains to be seen whether, after Belgium and France have presented their account,

* *Times*, November 7, 1918.
† *Times*, December 6, 1918.

it will be possible for us to secure payment even for all the civilian damage that we have suffered.

It thus appears that the net cost of the fighting period has been somewhere in the neighbourhood of £5500 millions, taking our loans to Allies at half their face value; and that the armistice and demobilisation period is likely to cost another £1000 to £1500 millions more, to say nothing of pensions and debt charge that will go on for years (unless the supporters of Levy on Capital have their way and wipe the debt out), and that against this further expenditure we can set whatever sum is recovered from Germany.

Seeing that our total pre-war debt was £710½ millions, or, omitting what the Government returns call the Other Capital Liabilities, £653½ millions, these figures of war debt and war cost are at first sight somewhat appalling. But there is no reason why they should terrify us, and there are several reasons why they are, when looked at with a discriminating eye, much less frightening than when we first set them out.

In the first place, we have always to remember that these figures are in after-war pounds, and that the after-war pound is, thanks to the profligate use by our war Governments of the printing-press and the banking machine, just about half the size, when measured in actual buying power, of the pre-war pound. Any one who pays £100 in taxes to-day thereby surrenders claims to about the same amount of goods and service as he did if he paid £50 in taxes before the war. So that in making any comparison

between the position now and the position then we have to divide the figures of to-day by two.

In the second, we need not be misled by the Jeremiahs who tell us that now that we have won the war we have before us the task of paying for it. This is not true, or true only to a small extent—to the extent, that is to say, to which we shall, when all these assets and liabilities have been settled up and balanced, be afflicted with a foreign debt. Let us leave this question on one side for the time being, and consider what the position really is with regard to that part of the war's cost that has been raised at home. In so far as that has been done, the war cost has been raised by us while the war went on. In fact, all the war cost has to be raised by somebody while the war goes on, because the war is fought with stuff and services produced at the time and paid for at the time. But when Americans lend us money to pay for some of the stuff that they send us, they pay at the time and we, or our posterity, have to pay them back later on; this is the only way in which we can make posterity pay for the war, and then it only means that our posterity pays America's. It is not possible to carry on war with wealth that is going to be produced some day. The effort of self-sacrifice that war demands has to be made by somebody during its progress—otherwise the war could not be fought.

That effort of self-sacrifice we have already made in so far as we have paid for our war cost out of money raised at home. That money has been raised in three ways—by taxation, by borrowing saved

money, and by inflation. When it is raised by taxation the sacrifice is obvious, and, in nearly all cases, inevitable: we pay our larger war taxes and so we have less to spend on ourselves, and so we go without things. A few people raise money to pay taxes during war by borrowing or drafts on capital, but they are probably so exceptional that their case need not be considered. We transfer our buying power to the Government to be used for the fighters, and so we set free the labour and material that used to go in providing us with comforts and pleasures; our competition for goods is reduced, and so the Government is able to get what it needs out of the nation's production. which is *pro tanto* relieved of our demand. The same thing happens when the Government gets money for the war by borrowing money that we save. We reduce expenditure, and transfer buying power to the State and diminish our demand on the nation's production, or that of its foreign supplies. If the whole war cost had been met by these two methods there need have been little or no increase in prices here, and the cost of the war would have been about half what it has been. Of the two methods, taxation is obviously the cleaner, simpler and more honest. By borrowing, the State hires those who have a margin to put part of it at the disposal of the State at a time of national crisis, instead of taking it from them outright. As most of the taxation involved by the subsequent debt charge falls on those who have a margin (as it obviously should) the result is that the people who subscribed to the loans are afterwards taxed to pay

themselves interest and to repay themselves their debt.

This subsequent taxation falls on them all alike in proportion to their ability to pay, or would if the income tax was more equitably imposed ; those who have subscribed their fair share to the loans have an offset, in the interest that they receive, against the taxation ; those who subscribed less are properly penalised, those who subscribed more are properly benefited. If only the income tax did not make the position of fathers of families so unjust, the whole arrangement would look, at first sight, quite fair, though rather absurd and clumsy, involving all this subscribing and taxing and paying back instead of an outright tax and having done with it. But in fact a very grave inequity is involved by this business of borrowing for war, and laid upon just the people whom we ought, above all, to treat most fairly, namely, those who fight for us. The soldiers and sailors risk their lives for a pittance during the war, while their brothers and sisters and cousins and uncles and aunts, left at home in security and comfort, earn bloated profits and wages, and put them, or part of them, into War Loans ; then when the fighters come back, very likely with their business and connection ruined or lost, they are expected to contribute to the taxation that goes into the pockets of debt-holders.

Inflation, the third method of paying for war, again produces the same effect of a reduction of consumption by the civilian population, but in a roundabout manner, which works at first without

being noticed, and so is particularly dear to the adroit politician. By it nobody transfers buying power to the Government, but the Government and the bankers, who are generally most reluctant accessories to the transaction, between them create new buying power, which, coming into a restricted market for goods in addition to all the existing buying power, simply forces everybody to consume less because the money in their pockets fetches less goods owing to the rise in prices.

The evil attached to this system is obvious enough. It amounts to a tax on the general consumer in proportion to his consumption, and so it lays the sacrifice on the shoulders of those least able to bear it. No Government would have the courage to impose such a tax openly and frankly. All the warring Governments in varying degrees have used this roundabout device of imposing it, very likely being quite unaware of the fraud on the consumer that they were perpetrating. Our own Government, in fact, having first added by this process to a rise in the price of bread, then reduced it by a special subsidy—a pleasant touch of Alice in Wonderland finance. This mode of taxing by raising prices hits, of course, all those who live on fixed incomes and salaries and wages. Those who can strike, or take more out of the consumer, can evade it, and so it falls on the weakest shoulders and incidentally produces friction, discontent and dangerous suspicion. But even it works at the time when it happens. Each creation of new buying power gives the Government, for the moment, control of so much in goods

and services at the expense of the consumer; but when once the new buying power has been distributed by the State's payments it is in the hands of the nation as a whole. If the process ceased, the nation would still have control of the whole of its output, which is its income, though the injustice involved, to those who are not strong enough to resist the effects of higher prices, would continue.

Thus, whatever means—straightforward or devious—are used for financing war, it is paid for while it goes on by the warring country if the financing is done at home, or by its foreign creditors if the financing is done abroad. And it is, necessarily, almost entirely paid for out of income, that is, out of current production. It is curious to find that many people still seem to think that the whole cost of the war has come out of capital. Luckily for us it could not be done, or only to a very small extent. Our capital mostly consisted of railways, factories, ships, roads, agricultural land, machinery, houses and other things that could not be taken and shot out of a gun. These things we have still got, and though many of them are not in such good shape as they were, some of them are much better equipped and organised. We have drawn on our stocks of materials and goods—how far it is impossible to say; we have lost 8½ million tons of shipping by war losses; in the meantime we have built, bought and captured 5½ millions of new tonnage, and we have a claim against the Germans for such tonnage. On capital account we have suffered by wear and tear in so far as our upkeep has been neglected owing to lack

of labour during the war, and by depletion of materials and stocks, and also, of course, by the fact that if the war had not happened, we should, if pre-war calculations were correct, have put some £1700 millions into new investments at home and abroad during the $4\frac{1}{4}$ years of fighting and some more hundreds of millions during the after-war period of Government borrowing and restriction on private investment. But a very large part of the money that went into victory would otherwise have gone not to capital account but into the pleasant frivolities, embellishments and vulgarities that made life an amusing absurdity in days before the war.

If, then, the war sacrifice was made during the war, in so far as its cost was raised at home, how far is it true that we are now faced with the business of paying for it? If taxation were equitable it would only be to the extent that those who ought to have made the sacrifice and did not, will in future have to pay interest to those who did, or their representatives. So that the first thing we have to do is to make taxation equitable, that is, lay it on the taxpayer in proportion to his ability to pay. There will still remain the injustice to those who have fought for us, which might be cured, or amended, by special exemptions. With taxation on a really sound basis no further sacrifice would be involved by the debt charge, and no diminution of the nation's wealth or consuming power, which will depend, as always, on its output of goods and services; but only a transfer of consuming power from taxpayers to debtholders in accordance with the sacrifice made by the latter

during the war. What we produce as a nation we shall consume as a nation, subject to the extent that we financed the war during its course by operations abroad.

These operations were twofold. We sold to foreigners part of our holdings of foreign securities, thereby and to this extent paying for war cost out of capital—out of the investments made by ourselves and our forbears in America and elsewhere. Mr Bonar Law, in a recent interview in the *Observer*, stated that we had sent back to the United States practically the whole of our holdings of American securities to be sold or pledged as collateral for loans, and that the value of them was three billion dollars—£600 millions sterling. Any of them that have only been pledged can presumably be used to meet the loans raised as they fall due, and so will lighten our burden in the matter of repayment. These loans raised abroad are the second mode of foreign financing. By it we had raised up to November 9th nearly £1300 millions, as shown by the *Economist's* table, and to that extent we have pledged our future production and that of our posterity, to meet the annual service for interest and repayment. On the other hand, all this sum and more we have (as shown above) lent to our Allies and Dominions, so that the ex-Chancellor was well justified in his boast that we had only borrowed to finance our Allies, and that we had been self-sufficient for our own war cost.*

In other words, all that we needed for the war we were able to produce ourselves, or to obtain in

* Budget Speech. Parliamentary Debates, vol. 105, No. 33.

exchange for our produce and assets. On paper, therefore, our position as a creditor country is only impaired by our sales of securities. But that is only so on paper. In fact, the loans that we have raised abroad are good debts that have to be met to the last penny, and are a first charge on our future output, but the advances that we have made to our Allies, much harder hit than we are by the war, are assets on which we cannot depend. They were taken in our balance-sheet above at half their face value, but there is much to be said for writing them off altogether and tearing up the I.O.U.'s of our foreign brothers-in-arms. Their need is greater than ours, it would be little satisfaction to receive interest and repayment from them, and the payment due from them, involving difficult problems of taxation for them, would not help the good relations with them which, we hope, may be a lasting effect of the war. And such an act of renunciation on our part would do something towards a restoration of the spirit with which we entered on war, a spirit which has been seriously demoralised during its course, largely owing to the results of our faulty finance, which encouraged profiteering in all classes.

In any case, there is our position. We have a big debt to meet at home and abroad, and we are weakened on capital account by foreign indebtedness, wear and tear of plant and dimunition of stocks and materials. Wear and tear and depletion we can soon make good if we set to work and work hard, if our bureaucracy takes away the fetters of its restrictions and controls (instead of making further

additions to the "Black List" even after the armistice!), and if our ruling wiseacres will refrain from trying to stimulate industry by taxing raw and half-raw materials. For the debt charge many pleasant and simple fancy strokes are suggested. The Levy on Capital is popular, especially with those who do not own any, but its advocacy is by no means confined to them. Mr Pethick Lawrence has published a persuasive little book about it, but I cannot see that he meets the objections to it. These are, the difficulty of valuation, the fact that in many cases it would have to be paid by instalments, and so would be merely another form of income tax, its sparing of the waster and penalising of the saver, and, consequently, the grave danger that it would check accumulation and so dry up the springs of capital. Mr Stilwell has produced a "Great Plan to Pay for the War," by which all the belligerents and neutrals who have been involved in expense by the war would receive World Bonds from an International Congress for what they have spent owing to the war, and would then pay one another any international debts by exchanging these World Bonds, and deal with the home debt by paying it off in new currency raised on the World Bonds. But, surely, to pay off war debt with a huge addition to currency, making war's inflation many times worse, would be a disastrous beginning to that new era which is alleged to be dawning.

By hard work, sparing consumption of luxuries, and a big industrial output, we can soon make the debt charge look smaller and smaller as compared

with our aggregate income. Our foreign debt we can only meet by shipping goods and rendering services. But since it was all raised to be lent to our Allies and our lending of it was essential to a victory which has rid mankind of a terrible menace, it is surely reasonable that our creditors should not press for repayment in the first few difficult years, but should fund our short-dated debts into loans with twenty-five or thirty years to run. As to the home debt, we can only lighten its burden on the taxpayer by making taxation equitable. To this end reform of the income tax is an urgent need. We have to lighten its pressure much more effectively on those who are bringing up families, and by collecting it through employers make it an effective and just tax on those of the working class whose earnings and family liabilities make them fairly subject to it.

XVIII

THE REGULATION OF THE CURRENCY

February, 1919

Macaulay on Depreciated Currency—Its Evils To-day—The Plight of the Rentier—Mr Goodenough's Suggestion—Sir Edward Holden's Criticisms of the Currency Committee—His Scheme of Reform—Two Departments or One in the Bank of England?—Not a Vital Question—The Ratio of Notes to Gold—Objections to a Hard-and-fast Ratio—The Limit on Note Issues—The Federal Reserve Act and American Optimism—Currency and Commercial Paper—A Central Gold Reserve with Central Control.

EVERYONE has read, and most of us have forgotten, the great passage in Macaulay's history which describes the evils of a disordered currency. "It may well be doubted," he says, "whether all the misery which had been inflicted on the English nation in a quarter of a century by bad Kings, bad Ministers, bad Parliaments and bad judges was equal to the misery caused in a single year by bad crowns and bad shillings. . . . While the honour and independence of the State were sold to a foreign Power, while chartered rights were invaded, while fundamental laws were violated, hundreds of thousands of quiet, honest and industrious families laboured and traded, ate their meals and lay down to rest in comfort and security. Whether Whigs or Tories, Protestants or Jesuits were uppermost, the grazier drove his beasts to market, the grocer weighed out

his currants, the draper measured out his broadcloth, the hum of buyers and sellers was as loud as ever in the towns, the harvest-time was celebrated as joyously as ever in the hamlets, the cream overflowed the pails of Cheshire, the apple juice foamed in the presses of Herefordshire, the piles of crockery glowed in the furnaces of the Trent, and the barrows of coal rolled fast along the timber railways of the Tyne. But when the great instrument of exchange became thoroughly deranged, all trade, all industry, were smitten as with a palsy. . . . Nothing could be purchased without a dispute. Over every counter there was wrangling from morning to night. The workman and his employer had a quarrel as regularly as the Saturday came round. On a fair-day or a market-day the clamours, the reproaches, the taunts, the curses, were incessant; and it was well if no booth was overturned, and no head broken. . . . The price of the necessaries of life, of shoes, of ale, of oatmeal, rose fast. The labourer found that the bit of metal which, when he received it was called a shilling, would hardly, when he wanted to purchase a pot of beer or a loaf of rye bread, go as far as sixpence."

From some of the evils thus dazzlingly described we are happily free in these times. We are not cursed with a currency composed of coins which are good, bad and indifferent, with the result that the public gets the bad and indifferent while the nimble bullion dealers absorb and export the good. There is nothing to choose between one piece of paper and another, and all that is wrong with them

is that there are too many of them. But the general result as it affects the labourer who wants to purchase a pot of beer or anyone else who wants to buy anything is very much the same. A bit of metal that is called a shilling has about the value of a pre-war sixpence and a bit of paper that is called a Bradbury fetches half as much as the pound of five years ago. Compared with what other peoples are suffering from the same disease arising from the same surfeit of money in one form or another, this nuisance that we are enduring is not too terribly severe. It has entailed great hardship on a class that is small in number, namely, those who have to live on fixed incomes. The salary-earner and the rentier have borne the brunt, while the wage-earner and the profit-maker have been able to expand their earnings, in paper, at least to a point at which the depreciation of currency have left them no worse off. Seeing that the wage-earners are those who do the dreariest and dirtiest jobs, and that the profit-makers are those who take the risks of industry and the enormous responsibility of organising enterprise, they are the classes whom it is clearly most desirable to encourage. The rentier in these days gets less than no sympathy, but we make a great mistake if we think that we can with impunity crush him between the upper and nether millstone of fixed income and rising prices. With his help we have equipped industry at home and abroad. We can, if we choose, by depreciating the currency still further, lessen still more the reward that we pay him for that benefit. He may kick, but he cannot

abolish the equipment with which he has already provided industry. But if we make his life too hard he can strike like the rest of us, and by refusing to provide for any further expansion in industrial equipment, he can hold up production until we have devised some new method of laying up capital. Currency depreciation is good for the debtor and bad for the creditor; if it goes too far it kills the creditor and reduces business to chaos.

We are a very long way from the chaos to which many of our Continental neighbours have already reduced their monetary systems; but there is fortunately a very general feeling that we are a country with a reputation and a prestige on this point; and the business world is growing restive concerning the delay on the part of those responsible in putting an end to a state of things which may have been justified by the war's exigencies (though there is much to be said for the view that in fact it only added to the war's difficulties) but is now clearly as out of date as the censorship, which, like it, nevertheless, continues to flourish. This state of things arises from the arrangement under which an unlimited supply of legal tender currency can be manufactured by the Government, which encouraged to continue the system by the fact that each note issued is in effect a loan to itself without interest. At the meeting of Barclays Bank on January 27th, Mr Goodenough demanded that the issue of currency notes by the Government should be stopped forthwith, and that if it were necessary to provide more currency it would be better for the banks to be

allowed to issue notes themselves. This suggestion involves, of course, a complete reversal of the principles on which our monetary system has grown up, since it has long been based on a note-issuing monopoly in the hands of the Bank of England. But these are topsy-turvy days, in which grey-headed precedent is very justly at a heavy discount; and Mr Goodenough's suggestion very practically gets over a big difficulty that stands in the way of stopping the stream of Bradburys. This difficulty lies in the fact that if the banks were pulled at by their customers for currency and could not supply them with Bradbury notes, they would be forced to take notes from the Bank of England, with a bad effect on the appearance of its reserve. If the business of issuing notes were put into the hands of the clearing banks, their power to do so would be limited by the extent of their assets, or of such of their assets as were thought fit to rank as backing for their notes. In other words, the note-issuing business would once more have to be regulated on banking principles and controlled by the price asked for advances, instead of expressing the helplessness and improvidence of an impecunious and invertebrate Government. In this manner the new departure might be a convenient halfway-house on the way from chaos back to sanity. But probably it is too revolutionary and goes too straight in the teeth of the Bank of England's privilege to receive much practical consideration; and there is the question whether the public would take the new paper readily and whether it could be made legal tender.

Sir Edward Holden, in one of those masterly surveys of world finance with which he now instructs the shareholders of the London Joint City and Midland Bank, assembled at their annual meeting, gave much of his attention to an attack on the report of Lord Cunliffe's Committee on Currency. This was only to be expected, since the Committee had made recommendations on lines which were largely conservative and did not embody any of the reforms or changes which had been previously advocated by Sir Edward. Being on this occasion chiefly critical, he did not make very clear in his latest speech the precise proposals that he favours. For them we have to go back to his speech of a year ago, as reported in the *Economist* of February 2, 1918, p. 171, where he stated that "if the Bank (of England) had been working on the same principles as other national banks of issue, there would have been little ground for anxiety," and that these principles are :—

1. One bank of issue and not divided into departments.

2. Notes are created and issued on the security of bills of exchange and on the cash balance, so that a relation is established between the notes issued and the discounts.

3. The notes issued are controlled by a fixed ratio of gold to notes or of the cash balance to notes.

4. This fixed ratio may be lowered by the payment of a tax.

5. The notes should not exceed three times the gold or the cash balance.

As will be remembered, the Cunliffe Committee recommended that the division of the Bank of England into an Issue Department and a Banking Department, should be retained; that the old principle by which above a certain fixed limit all notes should be backed by gold, should also be retained, but that if at any time a breach of this rule should be found necessary it should be possible, with the consent of the Treasury, and that Bank rate "should be raised to a rate sufficiently high to secure the earliest possible retirement of the excess issue." Since it was formerly only possible to exceed the limit on the fiduciary issue by a breach of the law, under the Chancellor of the Exchequer's promise to get an indemnity for it from Parliament, and since Treasury tradition insisted on a 10 per cent. Bank rate whenever such a breach was permitted or contemplated, it will be seen that the Cunliffe Committee proposed some considerable modifications in our system and hardly justified Sir Edward's assertion that it "proposed that the Bank should continue to work under the Act of 1844 as heretofore."

At first sight there seems to be a good deal of difference between Sir Edward's ideal and Lord Cunliffe's, but is not the difference to a great extent superficial? Whether the Bank be divided into two departments, each presenting a separate account, or its whole business be regarded as one and stated in one account, seems to be rather a trifling question. And the arguments put forward for their several views by the two champions are not strikingly

convincing. Sir Edward wants only one account, because he thinks the consequence would be a stronger reserve and fewer changes in bank rate. But a mere change of bookkeeping such as the amalgamation of the two accounts would not make a halfpennyworth of difference to the extent of the Bank's responsibilities and its ability to meet them, and it is on variations in these factors that movements in bank rate are in most cases decided. On the other hand, Lord Cunliffe and his colleagues argue that the main effect of putting the two departments into one would be to place deposits with the Bank of England in the same position as regards convertibility into gold as is now held by the note. On this point Sir Edward's answer is telling: "In reply to this statement, I say that the depositors at the present time can always get gold by drawing out notes from the reserve and taking gold from the Issue Department. There seems to be little difference between the depositors attacking gold direct and attacking the gold through the notes in the reserve. If the Bank cannot pay the notes when demanded the whole machinery stops." Quite so. The notion that the holder of a Bank of England note has now a stronger hold over the Bank's gold than the depositor seems to be baseless. He can exercise his hold more quickly perhaps, though even this is doubtful. Since banknotes are not legal tender at the Bank of England, it is not quite clear that the depositor would even have to take the trouble to go first to the Banking Department for notes and then to the Issue Department for gold.

He might be able to insist on gold in immediate payment of his deposit. Still less convincing is the Committee's argument that "the amalgamation of the two departments would inevitably lead in the end to State control of the creation of banking credit generally." Their report might have explained why this should be so, for to the ordinary mind the chain of consequence is not apparent. On the whole it is hard to see much good or harm to be achieved by changing the form of the Bank return. It might make the Bank's position look stronger, but it could not make it really stronger. Nor would it really impair the strength of the note-holder's position as against the depositor, because even now there is no essential difference. It would substitute a more businesslike and simple statement for a form of accounts which is cumbrous and stupid and Early Victorian—a relic of an age which produced the crinoline, the Crystal Palace and the Albert Memorial. On the other hand, to alter a statistical record merely for the sake of simplicity and symmetry is questionable. Unless we are getting more and truer information, it is a pity to make comparisons between one year and another difficult by changing the form in which figures are given.

A more essential difference between the two policies lies in Sir Edward's advocacy of a ratio—three to one—between notes and gold, and the Committee's support of the old fixed line system. By the latter, if gold comes in, notes to the same extent can be created, and if gold goes out notes to the amount of the export have to be cancelled. Under

Sir Edward's policy the influx and efflux of gold would have an effect on the note issue which would be three times the amount of the gold that came in or went out. This at least is the logical effect of his statement that "the notes should not exceed three times the gold or the cash balance." This law does not seem to be quite consistent with his view that the fixed ratio of gold to notes may be lowered by the payment of a tax; but presumably the tax would come into operation before the three to one part was reached, and at three to one there would be a firm line drawn. On this assumption the Committee's argument is a very strong one. "If," says its report (Cd. 9182, p. 8), "the actual note issue is really controlled by the proportion, the arrangement is liable to bring about very violent disturbances. Suppose, for example, that the proportion of gold to notes is actually fixed at one-third and is operative. Then, if the withdrawal of gold for export reduces the proportion below the prescribed limit, it is necessary to withdraw notes in the ratio of three to one. Any approach to the conditions under which the restriction would become actually operative would then be likely to cause even greater apprehension than the limitation of the Act of 1844." Certainly if, during a foreign drain, for every million of gold that went out, another two millions of credit, over and above, had to be cancelled, it is easy to imagine a very jumpy state of mind in Lombard Street and on the Stock Exchange. Sir Edward and the Committee seem to be agreed as to a limit on the note issue, but of the two

limiting systems the old one advocated by the Committee, though apparently more severe, would seem to have much less alarming possibilities behind it.

A point on which the commercial world does not seem to have made up its mind, however, is whether there should be a limit at all. Under the old Act there was a limit which could only be passed by a breach of the law. Under the Cunliffe proposal the limit could be passed with the consent of the Treasury. Sir Edward has not told us what machinery he proposes for the passing of the limit which he lays down; but in view of the great apprehension that an approach to the limit point would, as shown by the Committee, produce, it is clear that there would have to be a way round. In Germany there is no limit; you pay a tax on the excess issue and go on merrily. In America it would seem that the German system has been taken for a model. In his speech on January 29th Sir Edward quoted Senator Robert Owen, who was the principal pioneer of the Federal Reserve Bill through the Senate, as follows:—"The central idea of the system is elastic currency issued against commercial paper and gold, expanding and contracting according to the needs of commerce. . . . It is of great importance that the volume of these notes should contract when the commerce of the country does not require the notes to be circulation, and the reserve board can require them to be returned by imposing a tax upon the issue. . . . Under the reserve system a financial panic is impossible. People will not hoard currency nor hoard

gold when they know that they can get currency or get gold when required. . . . America no longer believes a financial panic possible, and therefore the business men, being perfectly assured as to the stability of credits, do not hesitate to enter manufacturing and commercial enterprises from which they would be deterred under old conditions of unstable credit." Well, let us hope the Senator is right and that America is right in believing that a financial panic is no longer possible there. But one cannot help feeling that such a belief may be rather dangerous in the minds of people so ready to take rose-coloured views as our American cousins. The Federal Reserve system has worked beautifully in a period in which American finance has had nothing to do but rake in the enormous profits of American production at the expense of warring Europe and lend part of them, to be spent in America, to the Allied belligerents. It may work equally well if and when the problem to be faced is different, but it will be interesting to see—for those of us who live to see—what sort of a tax will be needed to " require " America, in one of its holiday moods, to return currency that it thinks it needs and the Federal Reserve Board regards as redundant.

Another point on which Sir Edward lays great stress, in his attack on the Bank Act of 1844 and the Committee which supports its main principles, is the beauty of the bill of exchange as backing for a note issue, as opposed to Government securities. " There is," he says, " no automatic system for the redemption of currency notes as would be the case

if they were issued against bills of exchange, which in due course would have to be paid off." Again, "it seems to me that notes should not be issued against Government securities which may or may not be paid off, but against bills of exchange which must be met at due date." This advantage about a bill of exchange is a very real one to the individual holder who can always put himself in funds by letting the contents of his portfolio "run off"; but is there much in it as a safeguard against excessive issue of currency in times of exuberance? In such times bills that fall due are pretty sure to be replaced by new ones drawn against fresh production—since over-production is a common symptom of commercial exuberance—or against a resale of the goods on which the original bills were based. As long a anyone who can show produce can be certain to get credit and currency, the notion that the maturing of bills of exchange can be relied to restrict currency expansion within safe limits is surely a dangerous assumption. The principle of a fixed limit, to be broken in case of real need, but only after some ceremony has been gone through giving notice of the fact that a crisis has been reached, seems rather to be required by the psychology of speculative mankind. But even if Sir Edward's preference for bills of exchange as backing for notes has all the merits that he claims that is no reason for urging the repeal of the Bank Act to secure their use. Because the Bank Act does not forbid it: it merely says, "there shall be transferred, appropriated and set apart by the said governor and company to the

Issue Department of the Bank of England securities to the value of," etc. It is the practice of the Bank to put Government securities into the Issue Department, but the terms of the Act do not compel them to do so, and if an excess issue were needed they would seem to be empowered to put any bills that they discounted into the assets held against the note issue. On the whole the terms of the Act leaving them freedom in the matter, except with regard to the " Government debt " of £11 millions, which is specially mentioned as to be transferred to the Issue Department, seem to be preferable to a special stipulation in favour of bills of exchange.

But the most important difference between Sir Edward Holden and the Cunliffe Committee seems to be in their attitude towards the gold reserve and the relation between the Bank of England and the rest of the items that compose the London money market. The Committee, working to restore the conditions which made our market the centre of the world's finance, endeavoured to give back the control of the central gold reserve to the Bank of England by suggesting, among other things, that the other banks should hand over their gold to it. They omitted to discuss the serious question of the greater difficulty that the Bank is likely to find in future in controlling the price of money in the market, owing to the huge size that the chief clearing banks have now reached. But a central gold reserve under central control was evidently the object at which they aimed. Sir Edward will have none of this. He says that if this were done the position of the

Joint Stock banks would be weakened, though he does not explain why, since they would obviously hold notes in place of their gold and so would be able to meet their customers' demands, now that the latter are accustomed to the use of notes for pocket money. He points out that "the gold which was held by the Joint Stock banks before the war proved most useful. . . . At the beginning of the war the banks paid out gold, satisfied the demands of their customers for small currency, and thus eased the situation until currency notes became available." He seems to have forgotten that the banks, or most of them, refused to part with their gold, paid their customers in Bank of England notes which, being for £5 at the smallest, were of little use for pocket money, and so drove them to the Bank to get gold; and we had to have a prolonged bank holiday and a moratorium. Sir Edward is in favour of three gold reserves, one to be held by the Government, one by the clearing banks, and one by the Bank of England. If there were differences between the three controllers of the reserve at a time of crisis the consequence might be disastrous.

In view of the admiration expressed by Sir Edward for the new American system which is so clearly based on central control it is rather illogical that he should be so strongly in favour of independence on this side of the water. His opinion is that "the policy of the Joint Stock banks ought to be to make themselves independent of the Bank of England by maintaining large reserves in their vaults." Independence and individualism are a great source of

strength in most fields of financial activity, but in view of the great problems that our money market has to face there seems to be much to be said for co-operation and central control, at least until we have got back to a normal state of affairs with regard to the foreign exchanges.

XIX

TIGHTENING THE FETTERS OF FINANCE

March, 1919

The New Meaning of Licence—The Question of Capital Issues—Text of the Treasury Regulations—Their Scope and Effect—The Position of the Stock Exchange—Wider Issues at Stake—Should Capital be set Free?—The Arguments for and against—Perils of an Excessive Caution—The New Committee and its Terms of Reference—The Absurdity of prohibiting Share-splitting—The Storm in the House of Commons—Disappearance of the Retrospective Clause—A Sample of Bureaucratic Stupidity.

A CONTRAST between liberty and licence is a pleasant alliterative commonplace beloved by political writers, especially those with a reactionary bias. In the light of recent events it seems to be going to take a new meaning. Licence will soon be understood, not as the abuse of liberty, to which democracies are prone, but as a new weapon by which our bureaucracy will do away with liberty by tightening the shackles on our economic and other activities. For imports and exports the licence system is already familiar; if the mines and railways are to be nationalised we may have to be licensed before we can burn coal or go away for a week-end; if the Eugenists have their way a licence will be necessary before we can propagate the species; and before we can get a licence to do anything we shall have to go through

an exasperating process of filling in forms innumerable, inconsistent, overlapping and incomprehensible. Finance is the latest victim of this melancholy tendency. Under the guise of an attempt to give greater freedom to it a system has been introduced which makes a Treasury licence necessary, with penalties under the Defence of the Realm Act, for doing many things which have hitherto been possible for those who were prepared to forgo the privilege of a Stock Exchange quotation. Let the story be told in official language, as uttered through the Press Bureau, on February 24th, in "Serial No. C. 10917."

"In view of the changed conditions resulting from the conclusion of the armistice, the Treasury has had under consideration the arrangements which have been in force during the war for the control of New Issues of Capital.

"The work of scrutinising proposals for new Capital Issues has been performed during the war by the Capital Issues Committee, the object being to refuse sanction for all projects not immediately connected with the successful prosecution of the war. The decisions of the Treasury, taken upon the advice of this Committee, have, however, not had any binding force, beyond what is derived from the emergency regulations of the Stock Exchange, which forbids dealings in any new Issues which have not received Treasury consent.

"While it is not possible under existing financial conditions to dispense altogether with the control of Capital Issues, it has clearly become necessary

to reconsider the principles upon which sanction has been given or refused in order that no avoidable obstacles may be placed in the way of providing the Capital necessary for the speedy restoration of Commerce and Industry, and the development of public utility services.

"In view of the numbers of the proposals for fresh Issues of Capital which are to be expected, it is necessary to provide further machinery for dealing with them and for making the decisions upon them effective.

"A regulation under the Defence of the Realm Act has accordingly been made prohibiting all Capital Issues except under licence from the Treasury, and the Capital Issues Committee has been reconstituted with new Terms of Reference, which are as follows:—

"'To consider and advise upon applications received by the Treasury for licences under Defence of the Regulation (30 F) for fresh Issues of Capital, with a view to preserving Capital during the reconstruction period for essential undertakings in the United Kingdom, and to preventing any avoidable drain upon Foreign Exchanges by the export of Capital, except where it is shown to the satisfaction of the Treasury that special circumstances exist.'

"It will be an instruction to the Committee that, in order that applications may be dealt with expeditiously and to enable oral evidence to be given in support of them when desired by the applicant, that the Committee should sit by Panels consisting of three members, the decision of the Panels to be subject to confirmation by the full Committee.

" All applications for licences must be made, in the first instance, in writing on a Form which can be obtained from the Secretary of the Capital Issues Committee, Treasury, S.W. 1.

" Before any application is refused the Committee will give the applicant an opportunity of giving oral evidence in support of his case."

The notice then proceeded to recite the terms of D.O.R.A. 30 F, of which more anon. Next day came a supplementary announcement, " Serial No. C 10938," as follows :—

" With reference to the recent announcement in the Press that all applications for Treasury licences must be made in writing on a form obtainable from the Secretary of the Capital Issues Committee, Treasury, S.W. 1, delay will be avoided if intending applicants will state which of the following forms they require :—

Form No. 1. Issue by a proposed New Company to start a fresh business.

Form No. 2. Issue by an Existing Company (other than for the purpose of capitalising profits).

Form No. 3. Issue by an Existing Company for the purpose of capitalising profits.

Form No. 4. Conversion of a Firm into a Limited Company which does Not involve the introduction of fresh capital.

Form No. 5. Conversion of a Firm into a Limited Company which Does involve the introduction of fresh capital.

If none of the above Forms appears to be applicable

(as, *e.g.*, in amalgamations, sub-divisions of shares, etc.), a statement of the facts should be submitted in writing."

Before we go on to consider the new regulation, 30 F, let us try to see what is the real effect of the document above quoted. It was evidently intended to be a relaxation of the control of finance. This is shown by the sentence which says that the matter was to be reconsidered " in order that no avoidable obstacle may be placed in the way of providing the capital necessary for the speedy restoration of commerce and industry, and the development of public utility services." And yet it was thought necessary to give legal force and attach penalties to regulations that have worked during the war quite sufficiently well to secure a much stricter control than is now required. The explanation of this apparent inconsistency is probably to be found in the desire of the Government to meet a grievance of the Stock Exchange. Hitherto the only penalty that befell those who made a new issue without getting Treasury sanction was that the securities issued could not be dealt in on the Stock Exchange. The practical effect of this was that those who acted without Treasury sanction could only issue securities subject to this serious drawback, and so an effective but not altogether prohibitive bar was put on the process. If this bar was not strong enough in war-time it ought clearly to have been strengthened long ago ; if it was strong enough, then why should it be strengthened now ?

From the Stock Exchange point of view it is easy

to make out a good case for working through licence and penalty rather than through the banning, of the securities effected, from sanction for dealings. By thus being used as an official weapon the Stock Exchange penalised itself and its members. By saying " no security not sanctioned by the Treasury shall be dealt in here," its Committee restricted business in the House and drove it outside. This grievance was obvious and was plentifully commented on during the war. If the Committee had pressed the point vigorously it could probably have forced the Government long ago to abolish the grievance by making all dealings in new issues that appeared without Treasury sanction illegal and liable to penalty. A patriotic readiness to fall in with the Government's desires was probably the reason why the Stock Exchange refrained from embarrassing it, during the war, by too active protests against a grievance that was then more or less real; though it should be noted that even if the grievance had been amended, the Stock Exchange would not necessarily have got any more business, but would only have succeeded in stopping a very moderate amount of business that was being done by outsiders. But when all is said that can be said for the justice of the case that can be made by the Stock Exchange, the question still arises whether it was advisable, at a time when relaxation of restrictions was desirable in the interests of the revival of industry, to draw tighter bonds which had been found tight enough to do their work. That the Stock Exchange should suffer from limitations from

which outside dealers were exempt was certainly a hardship. On the other hand, since the armistice there has been a considerable expansion in Stock Exchange business. Oil shares, Mexican securities, industrial shares, insurance shares, and others in which capitalisation of reserves and bonus issues have been used as an effective lever for speculation, have enjoyed spells of considerable activity. With this revival in progress, in spite of many obvious bear points, such as industrial unrest at home, Bolshevism abroad, the continuance of heavy expenditure by the Government, and the hardly slackened growth of the national debt, it seems to have been scarcely necessary in the interests of the House to have made regulations which, though perhaps demanded by abstract justice, imposed new ties on enterprise at a time when complete freedom, as far as it was consistent with the best interests of the country, was most of all desirable.

How far, we have next to ask, is it necessary for the best interests of the country to restrict the freedom of capital issues? If we look back at the terms of reference under which the reconstituted Committee is to work, we see that the officially expressed objects are (1) preserving capital for essential undertakings in the United Kingdom, and (2) preventing any avoidable drain upon Foreign Exchanges by the export of capital. There is certainly much to be said for both these objects. When we lend money to foreigners we give them the right to draw on us now in return for their promises to pay some day; in other words, we make an invisible

import of foreign securities, and in the present state of our trade balance all imports, whether visible or invisible, need careful watching. It is also very evident that at a time when capital is scarce there is much to be said for keeping it for essential industries, especially those which produce necessaries and goods for export, and not allowing it to be swept up by borrowers who are going to devote it to making expensive fripperies on which big profits are probable.

There remains a very big other side to both these questions. All over the world there is a demand for goods which have not been produced, or only in greatly reduced quantities, during the war. This demand is only effective in so far as willing buyers can pay; some of them have the needful cash in hand or waiting in London or elsewhere to be drawn on, but a great number of would-be buyers want to be financed, and will have to be financed by somebody if the needs that they feel are to be translated into actual purchases. In other words, in order that the wheels of industry are to be set turning as fast as they might, if they had a full chance, somebody has to lend freely. Now, it is surely most of all important in the national interest that those wheels should begin spinning as fast as possible, and the question is whether we are more likely to serve that interest best by keeping a meticulous eye on the course of exchange and buttoning up our pockets to foreign borrowers or by leaving capital free to seek its market, knowing that every time we give the foreigner the right to draw on us we stimulate our export trade, because

his drawing must finally mean a demand on us for something—goods, securities or gold—and goods are what people are in these times most anxious to take. If we are going to leave all the financing to be done by America and fear to import promises to pay lest they should be followed by demands on our gold, shall we not be rather in the position of Barry Lyndon, who was given a gold piece by his mother when he went out into the world, with strict injunctions always to keep it in his pocket and never to change it? Regard for our gold standard is most necessary, but the gold standard is not an end in itself, but merely an important part of a machine which only exists to serve our industry. If we are so careful of the machine, which is a mere subsidiary, that we check the industry which it is there to serve, we shall be like the dandy who got wet through because he had not the heart to unfurl his beautifully rolled-up umbrella.

Again, it looks very sound and sensible to keep capital for purposes that are essential, but, on the other hand, it is so enormously important to set industry going as fast as possible that almost any one who will do anything in that direction is entitled to be given a chance. In war-time, when labour and materials were so scarce that they could not turn out all the munitions that were necessary, such a restriction was clearly inevitable. Now, when labour and materials are becoming more plentiful, and the scarce commodity is the pluck and enterprise that will take the risks involved by getting to work on a peace basis, it may be argued that

any one who will take those risks, whatever be the stuff or services that he proposes to produce, should be encouraged rather than checked. It is again a question of the balance of advantage. If we are going to be so careful in seeing that capital is not put to a wrong use that we take all the heart out of those who want to make use of it, we shall do more harm than good. If by leaving capital free to go into any enterprise that it fancies we can give a start to industry and promote a spirit of courage and enterprise among its captains, it will be well worth while to do so at the expense of seeing a certain amount of capital going into the production of articles that the community might, if it made a more reasonable use of its purchasing power, very well do without. The same question arises when we consider the desire of the Government, not expressed in the above statement, but very freely admitted by Mr Bonar Law, in discussing it in the House of Commons, to keep capital to be lent to it rather than expended in, perhaps unnecessary, industry. Here, again, it is clearly in the interest of the taxpayer that Government loans should be raised on the most favourable terms possible. But if, in order to do so, we starve industry of capital that it needs, and so check the production on which all of us, Government and citizens alike, ultimately have to live, we shall be scoring an immediate advantage at the expense of future progress—spoiling a possibly brilliant break by putting down the white ball for a couple of points.

There is thus a good deal to be said for setting

capital free, before we have even arrived at the most serious objection to regulating it under Treasury licence. This objection is the exasperation, delay and uncertainty involved by this control. Even if we had an ideally wise and expeditious body to decide about capital issues it might not be the best thing to set it to work. But when we remember that in order to see that the wrong sort of issue is not made, all issues will have to pass through the terribly slow-working process of official selection before the necessary licence is finally granted, it begins to look still more likely that we should do well to run the risk of letting a few goats through the gate, rather than keep all the sheep waiting outside for months, with the probable result that many of them may lose altogether their chance of final salvation. It will be noted from the official statement that the arbitrary methods of the old Committee are to be modified. It has long been a by-word among those who had dealings with it; they abused it in quite sulphurous language and were wont to quote it as an example of all that bureaucratic tyranny is and should not be, thereby doing some injustice to our bureaucrats, seeing that the Committee was manned not by officials but by business men, clothed *pro hac vice* in the thunder of Whitehall. The new Committee is to sit by panels of three, so as to expedite matters, and so as to allow applicants the privilege of giving oral evidence. This is an innovation that will save some exasperation, but it will hardly accelerate matters, especially as the decision of the panels will

be subject to confirmation by the full Committee, so that all the work will have to be done twice over. There is thus much reason to fear that delay, so fatal in business matters, will be an inevitable offspring of the efforts of the new Committee, and the list of different forms on which applications are to be made, given above, shows that all the paraphernalia of red tape will dominate the proceedings.

Now for the terms of the new Regulation under the Defence of the Realm Act.

"1. The following regulation shall be inserted after Regulation 30 EE :—

"30 F. The following provisions shall have effect in respect of new capital issues and to dealings in securities issued for the purpose of raising capital :

"(1) No person shall, except under and in pursuance of a licence granted by the Treasury—

"(*a*) issue, whether for cash or otherwise, any stock, shares or securities ; or

"(*b*) pay or receive any money on loan on the terms express or implied that the money is to be or may be applied at some future date in payment of any stock, shares or securities to be issued at whatever date to the person making the loan ; or

"(*c*) sub-divide any shares or Debentures into shares or Debentures of a smaller denomination, or consolidate any shares or Debentures of a larger denomination ; or

"(*d*) renew or extend the period of maturity of any securities ; or

"(*e*) purchase, sell or otherwise transfer any

stock, shares or securities or any interest therein, or the benefit of any agreement conferring a right to receive any stock, shares or securities, if the stock, shares or securities were issued, sub-divided or consolidated, or renewed or the period of maturity thereof extended, or the agreement was made, as the case may be, at any time between the 18th day of January, 1915, and the 24th day of February, 1919, and the permission of the Treasury was not obtained to the issue, sub-division, consolidation, renewal or extension or the making of the agreement, as the case may be.

" (2) No person shall except under and in pursuance of a licence granted by the Treasury—

" (*a*) buy or sell any stock, shares or other securities except for cash or when the purchase or sale takes place in any recognised Stock Exchange, subject to the rules or regulations of such exchange.

" (*b*) buy or sell any stock, shares or other securities which have not remained in physical possession in the United Kingdom since the 30th September, 1914.

" (3) A licence granted under this regulation may be granted subject to any terms and conditions specified therein.

" (4) If any person acts in contravention of this regulation, or if any person to whom a licence has been granted under this regulation subject to any

terms or conditions fails to comply with these terms or conditions, he shall be guilty of a summary offence against these regulations.

"(5) In this regulation the expression 'securities' includes Bonds, Debentures, Debenture stock, and marketable securities."

It will be seen at once that the terms of this document, on any interpretation of them, go far beyond the intentions expressed in what may be called the official preamble and in the new Committee's terms of reference. One of the clauses seems, with all deference to its august composers, to be merely silly. This is (1) (*c*) forbidding subdivision of securities. If a £10 share is split into ten £1 shares this operation cannot make the smallest difference to the supply of capital for essential industries or cause any drain on the Foreign Exchanges. I am assured by those who have delved into the official intention that the reason for the objection of the old Committee to splitting schemes, on which this new prohibition is based, was that splitting made shares more marketable and popular and so more likely to compete with War Bonds. But a mere sale of shares, split small and so popularised, does not absorb any capital. That only happens when money is put into some new form of industry. If A, who holds ten £20 shares, is enabled to dispose of them to B because they are split into 200 £1 shares, then A instead of B has got the money and has to invest it in something. The amount of capital available for investment is not diminished by a halfpenny. This regulation is just a piece of

short-sighted tyranny which exasperates without doing the smallest good to anybody.

More serious, however, was clause (1) (*e*), under which any securities that have been issued, split, consolidated or renewed without Treasury sanction since January, 1915, were not to be dealt in, in future, without a licence. The result of this clause, if it had stood, would have been that all loans under which such securities had been pledged would have had to be called in because the collateral became unsaleable, except after all the ceremonies had been gone through and a licence had been got. It was also possible to argue that the prohibition to renew or extend the maturity of any security meant that no loans of any kind could be renewed, and that no commercial bills could be renewed, without a licence. It is true that No. 5 paragraph says what the expression " securities " includes, but it does not state definitely that bonds, Debentures, Debenture stock and marketable securities are the only things included. It was a pretty piece of drafting, and raised a pretty storm in the House of Commons on February 27th, when a somewhat lurid picture of its effects was drawn by Sir H. Dalziel and Mr Macquisten. Mr Chamberlain not being then legally a member of the House, it fell to the lot of Mr Bonar Law to explain that the Government had really meant to give greater freedom in making new issues, that the evils anticipated had not been intended, that he hoped the House would not judge the Government too harshly for not making unsanctioned issues illegal from the beginning, and that a new

Order would be issued removing the retrospective effect of the new regulation. And so amendment was promised of a measure which would have had very awkward and unjust effects. It may be argued that it would only have affected people who had done, during the war, what they were asked not to do, namely, make issues without Treasury sanction. If the old Committee had been a reasonable and expeditious body this argument would have had great weight. But, in view of its caprices and dilatoriness, there was a good deal of excuse for those who decided to do without Treasury sanction and take the consequence of being unable to market their securities on the Stock Exchange. To propose to add a new penalty and cause the cancelling of all the financial arrangements made in connexion with such issues during four years was simply piling blunder on blunder. Luckily, the protests of the Government's own supporters sufficed to undo the worst of the mischief; but the whole affair is only another argument in favour of the earliest possible ridding of finance and industry from control that is so clumsily exercised.

XX

* MONEY OR GOODS?

December, 1918

"Boundless Wealth"—Money and the Volume of Trade—The Quantity Theory—The Gold Standard—How is the Volume of Paper to be regulated?—Mr Kitson's Ideal.

In the November *Trade Supplement* an endeavour was made to answer Mr Kitson's rather vague and general insinuations and charges against our bankers concerning the manner in which they do their business. Now let us examine the larger and more interesting problem raised by his criticism of our currency system.

In his article in the June *Supplement* he told us that "if the British public had any grasp of the fundamental truths of economic science they would know that a future of boundless wealth and prosperity is theirs." This is a cheery and encouraging view and, let us hope, a true one. But, that boundless wealth can only be got if we work for it in the right way. Can Mr Kitson show it to us, and what are these "fundamental truths of economic science"? It is easier to talk about them than to find any two

* This was the latter of two articles contributed to the *Times Trade Supplement* in answer to a series in which Mr Arthur Kitson had attacked our banking and currency system and suggested an inconvertible paper currency.

economists who would give an exactly—or even nearly—similar list of them. Mr Kitson glances "at a few elementary truths." "Wealth," he says, "is the product of two prime factors, man and Nature, generally termed labour and land. With an unlimited, or practically unlimited, supply of these two factors, how is it that wealth is and has been hitherto so comparatively scarce?" But is the supply of "man" unlimited in the sense of man able, willing, and properly trained to work? And is the supply of "Nature" unlimited in the sense of land, mines, and factories fully equipped with the right machinery and served and supplied by adequate means of transport? Surely the failure in production on which Mr Kitson so rightly lays stress is due, at least partly, to lack of good workers, good organisers, good machinery, and good transport facilities. Workers who restrict output, employers who despise science and cling to antiquated methods, the opposition of both classes to new and efficient equipment, and large tracts, even of our own land, still without reasonable transport facilities, have something to do with it. And lack of capital—this answer to the question Mr Kitson flouts because, he says, "since capital is wealth," to say that "wealth is scarce because capital is scarce is the same as saying that wealth is scarce because it is scarce." But is it not a "fundamental truth of economic science" that capital is wealth applied to production? Wealth and capital are by no means identical. When a well-known shipbuilding magnate laid waste several Surrey farms to make

himself a deer-park, the ground that he thus abused was still wealth, but it is no longer capital because it has ceased to produce good food and is merely a pleasant lounging-place for his lordship. May not the failure of production be partly due to the fact that, owing to the extravagant and stupid expenditure of so many of the rich, too much work is put into providing luxuries—of which the above-mentioned deer-park is an example—and too little into the equipment of industry with the plant that it needs for its due expansion?

Mr Kitson's answer is much easier. According to him, instead of working better, organising better, and putting more of our output into plant and equipment and less into self-indulgence and vulgarity all that we have to do to work the necessary reform is to provide more money and credit. Since, he says, under the industrial era—

"All goods were made primarily for exchange or rather for sale . . . it followed, therefore, that production could only continue so long as sales could be effected; and since sales were limited by the amount of money or credit offered, it followed that production was necessarily limited by the quantity of money or credit available for commercial purposes."

But is this so? If goods are produced more rapidly than money, it does not follow that they could not be sold, but only that they would have been sold for less money. The producer would have made a smaller profit, but on the other hand the cheapening of the product would have improved the position of the consumer, the cheapening of

materials would have benefited the manufacturer, and it is just possible that production, instead of being limited, might have been stimulated by cheapness due to scarcity of currency and credit, or, at least, might have gone on just as well on a lower all-round level of prices. On the whole, it is perhaps more probable that a steady rise in prices caused by a gradual increase in the volume of currency and credit would have the more beneficial effect in stimulating the energies of producers. But Mr Kitson's argument that the volume of currency and credit imposes an absolute limit on the volume of production is surely much too clean-cut an assumption. This absolute limit may be true, if currency cannot be increased, with regard to the aggregate value in money of the goods produced. But money value and volume are two quite different things. If our credit system had not been developed as it has, and we had had to rely on actual gold and silver for carrying on all production and trade, it does not by any means follow that trade and production might not have been on something like their present scale in the matter of volume and turnover; but the money value would have been much smaller because prices would have been all round at a much lower level.

This contention is based on what is called the "Quantity Theory of Money." This theory Mr Kitson wholeheartedly believes, so that this is not a point that has to be argued with him. "The value of money," he says, "as every student of economics knows, is determined by the quantity

of money in use and its velocity of circulation." Quite so. If you increase the amount of money faster than that of goods, more money has to be given for less goods; the value, or buying power, of money is depreciated and prices go up. The present war has given an excellent example of this process at work. All the warring Governments have printed acres of paper money, and have worked the credit system with profligate energy; and so we have a huge increase in currency and credit, along with little or no increase (probably a decrease) in consumable goods, and prices have soared like rockets all over the world. In neutral countries the rise has been as bad as anywhere, because the neutrals have been choked with the gold that the warring Powers exported, putting paper in its place. So we see that the volume of money, on the theory so emphatically expounded by Mr Kitson and endorsed by common-sense—as long as we are careful to include all forms of money that are taken in exchange for goods in the definition—reflects itself at once in prices. If money does not increase in quantity and goods do, then prices go down, and after the necessary adjustments are made in rates of wages and salaries, a larger trade can be done with the same amount of money at a lower level of values. The volume of money thus limits the aggregate value of trade, but not its aggregate volume. Periods of falling prices are not encouraging to producers, and they put too much advantage into the hands of the *rentier*—the man who lives on fixed interest; on the other hand, they are generally

believed to be in favour of the working classes, since reductions in wages generally lag behind the fall in prices, which means increased buying power to the wage-earner.

Mr Kitson's view that the volume of trade is limited by the quantity of currency and credit is thus based on confusion between volume and value. Moreover, it follows also from the "Quantity Theory of Money," which he holds, that if he applies his remedy and multiplies currency and credit as fast as he appears to want to, the result will be a still further depreciation in the buying power of money, and a further rise in prices and an increase in all the bitterness, discontent, suspicion, and strikes that the rise in prices has already caused during the war. Is this a prospect to pray for? Surely if we want to enjoy "boundless wealth and prosperity" the way to do so is to turn out goods—things to eat and wear and enjoy—and not to multiply money, thereby merely depreciating its value, on Mr Kitson's own admission. He thinks that "nothing but an abundant supply of currency in the shape of legal tender notes and bank credit, could have enabled us to undertake successfully such unprecedented burdens" as we have borne during the war. But it may equally well be argued that we have borne these burdens because we worked harder than ever before to turn out the needed stuff, organised better, used our machinery to its full power, and spent less of our product on luxuries; and that the abundant currency, by forcing up prices, immensely increased the cost of the war and produced industrial friction

which several times brought us unpleasantly close to disaster.

Mr Kitson, however, uses the "Quantity Theory of Money"—the doctrine that the value or buying power of money varies according to its quantity in relation to that of the goods that it buys—chiefly as a stick wherewith to beat the Gold Standard. He shows, very easily and truly, that it is absurd to suppose that the value of the monetary gold standard is invariable. Thereby he is only beating a dead horse, for no such argument is nowadays put forward. The variability of the gold standard of value is acknowledged, whenever a fluctuation in the general level of commodity prices is recorded. But gold is the basis of our credit system, and of those of all the economically civilised countries of the world, not because its value is believed to be invariable, but because it is the commodity which is universally accepted, in such countries and in normal times, in payment of debts. This quality of acceptability it has got largely by custom and convention. Mr Kitson speaks of the "selection of gold by the world's bankers as the basis for money and credit." But it was selected as currency by common custom long before bankers were heard of. And it was selected because of its permanence, ductility and other qualities, especially its beauty as ornament, which made man, eager to adorn himself, his womenkind, and the temples of his gods, always ready to accept it in payment, knowing also that, because of this acceptability, he would always be able to exchange it into any goods that he wanted.

Any other commodity that earned this quality of universal acceptability could do the work of gold just as well. But until one has been found, gold, as long as it keeps that quality, holds the field. And bankers use it as the basis for money and credit, not because, as Mr Kitson says, they selected it owing to its scarcity, but because this quality of universal acceptability made it the thing in which all debts, both at home and abroad, could be paid. "Given," says Mr Kitson, "a self-contained trading community with a certain quantity of legal tender, just sufficient for its commercial needs, and it makes no difference either to the value or efficiency of the money or to the trade affected whether it be made of metal or paper." Quite so, but trading communities are not self-contained. Their currency has to be convertible into something acceptable abroad, and that something is, at present, gold. It is possible that the world may some day evolve an international paper currency that will be everywhere acceptable. But such an ideal requires a growth of honesty and mutual confidence among the nations that puts it a long way off. And how is its volume to be regulated?

This question is all-important, whether the currency be national or international. Mr Kitson speaks of a currency "just sufficient" for the community's commercial needs. Who is to decide when the currency is just sufficient? The Government? A sweet world we should live in, if among other party questions, Parliament had to consider multiplying or contracting the currency every year or

every month, with all the interests that would be affected by the consequent rise or fall in prices, lobbying, speech-making, and pulling strings to work the oracle to suit their pockets. And, according to Mr Kitson's view, that the volume of trade is limited by the supply of currency, this volume would then depend on the whims of the House of Commons, half the members of which would probably be innocent of a glimmering of understanding of the enormously important question that they were deciding. The gold standard, which makes the course of prices depend, more or less, on the chances of digging up a capricious metal from the bowels of the earth, has its obvious drawbacks; but it is a clean and sensible business compared with making them depend on the caprices of Parliament, complicated by the political corruption that would be only too likely to follow the putting of such a question into the hands of our elected and hereditary representatives and rulers.

Such, however, seems to be the Promised Land to which Mr Kitson wants to lead us. Thus he propounds his remedy. "The remedy is surely obvious. Divorce our legal tender from its alliance with gold entirely, so that the supply of money and credit for our home trade is no longer dependent upon our foreign trade rivals. Base our currency upon the national credit . . . treat gold as a commodity only, for the settlement of foreign trade balances."

This passage in his article in the September *Supplement* tells us what to do. Keep gold, out of

deference for foreign prejudice, for the settlement of foreign trade balances, but make as much paper money as you like for home use. As our legal tender money is to be "divorced entirely from its alliance with gold" it clearly cannot be convertible into gold. So that apparently we shall have a paper pound and a gold pound (the latter for foreign use) with no connection between them. This stage of economic barbarism has been left behind now even by some of the South American republics. The paper pound, based on the national credit, can be multiplied as fast as our legislators think fit. If they do not multiply it fast enough, Mr Kitson will tell them that they are strangling trade, because the volume of production is limited by the amount of money available. At the same time bank credits will be multiplied indefinitely because, as was shown in the November *Supplement*, Mr Kitson supports a view that the average business man holds (according to him) that he ought to have a legal right to as much credit as he wants. With the Government printing paper to please its supporters, with the banks obliged by law to give credit to every one who asks for it, and with prices soaring on every addition to currency and credit, what a country this will be to live in, and what a life will be led by those who have to compile and work out the index numbers of the prices of commodities! Some of us, perhaps, will prefer the jog-trot conservatism of Lord Cunliffe's Currency Committee, who in their recently issued report * (which every one ought to read)

* Cd. 9182. 2*d*.

recommend that gold should not be used for circulation at present, but that endeavours should be made towards the cautious reduction of our swollen paper currency, and that its convertibility into gold should be maintained.

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